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The Social Reform of Banking

Conley, J. & Williams, C. (2014). The social reform of banking. *Journal of Corporation Law,* 39(3), 101-134.

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Abstract:
Recent developments in banking, including high-profile prosecutions for illegal activities, portend further regulatory interventions on both sides of the Atlantic. Yet the structure of much banking regulation requires banks to make good faith determinations of the kinds of risks to which their loans and investments give rise -- determinations that can be, and in some cases have been, manipulated. Rather than evaluating specific regulatory interventions, this Article focuses on the culture within financial institutions themselves, particularly the global entities that are explicitly or implicitly too-big-to-fail, and on approaches to regulation that might affect and be affected by that culture. Our analysis is informed by the perspectives of anthropology, organizational and social psychology, and new governance regulatory theory. Weaving these strands of prior research together, the Article concludes with suggestions for reform, emphasizing structural reforms, accounting reforms (informed by ideas derived from both organizational psychology and transnational private regulation), and other regulatory approaches that might encourage cultural reforms within banking.

Keywords:
financial regulation, regulatory theory, self-regulation, co-regulation, corporate culture, banking culture, new governance, Equator Principles, organizational psychology, corporate compliance, accounting reform, social accounting, social disclosure

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The Social Reform of Banking

Cynthia A. Williams*

John M. Conley**

"The idea that there is something called 'the economy', which is separable from the welfare of society and its citizens, is silly."[1]

"The economic power in the hands of the few persons who control a giant corporation is a tremendous force which can harm or benefit a multitude of individuals, affect whole districts, shift the currents of trade, bring ruin to one community and prosperity to another. The organizations which they control have passed far beyond the realm of private enterprise—they have become more nearly social institutions."[2]

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1. John Kay, *Scrap the Jubilee? Why not Christmas Too?*, JOHN KAY (May 30, 2012), http://www.johnkay.com/2012/05130/scrap-the-jubilee-why-not-christmas-too.

2. Adolf A. Berle, Jr. & Gardiner C. Means, THE MODERN CORPORATION AND PRIVATE PROPERTY 46 (New York: Harcourt, Brace & World rev. ed. 1968) (c. 1932).

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I. INTRODUCTION

When the global elite gathered to discuss the state of the world economy at the World Economic Forum in Davos in January 2011, the prevailing mood ranged from optimistic to exuberant. The apocalypse had been averted, and it seemed that the financial system and the world economy were both recovering. But there was an ant at the picnic: Barrie Wilkinson, an analyst from the international consulting firm Oliver Wyman, whom a Bloomberg reporter dubbed the "Loneliest Man in Davos."[3] Wilkinson (whose lower-rung credentials kept him out of the most exclusive celebratory events) had written a report for his company that concluded as follows:

> [F]or all the rhetoric around a new financial order, and all the improvements made, many of the old risks remain. The basic regulatory framework—of bank debtor guarantees and regulatory bank capital and liquidity minima (that is, of risk subsidies and compensatory risk taxes)—has been maintained with tweaked parameters. And, within this system, bank shareholders, bondholders and executives still have incentives that might herd them towards excessive risk taking.[4]

In its analysis, the Oliver Wyman report emphasized a number of fundamental problems that it argued had not been solved.[5] A particular concern was that shareholders' unwillingness to accept the lower returns on equity that higher capital requirements would produce would lead banks to shift resources either into commodities or emerging markets with expectations of higher returns. This reluctance to accept lower returns would create two problems: it would either fuel new asset bubbles or cause banks to continue to shift banking functions into the less-regulated interstices of the shadow banking system.

By today, however, that analysis seems understated, especially after a particularly scandal-plagued summer in 2012, with echoes in 2013. Not only is it now clear that the

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3. Christine Harper, *Loneliest Man in Davos Foresees 2015 Bank Crisis While Global Elites Party*, BLOOMBERG (Jan. 30, 2011, 9:23 PM), http://www.bloomberg.com/news/2011-01-31/lonely-analyst-warns-of-2015-bank-crisis-amid-upbeat-davos.html.

4. *The Financial Crisis of 2015: An Avoidable History*, OLIVER WYMAN 24 (2011), http://www.er.ethz.ch/fco/TheFinancialCrisis2015-OliverWyman.pdf.

5. *See generally id.*

old risks remain, but it is becoming increasingly clear that there are additional, deeper problems to confront. Thus, in rapid succession, public charges emerged that traders at up to sixteen of the too-big-to-fail global banks, including Barclays, Citigroup, UBS, and HSBC, had engaged in global manipulation of the London inter-bank offered rate, or Libor, for at least five years.[6] In addition, charges surfaced that HSBC subsidiaries had been knowingly laundering money for drug cartels, terrorists, and pariah states for over a decade;[7] that the vaunted risk mitigation systems at JPMorgan Chase had been insufficient to prevent $5.8 billion worth of surprise losses in synthetic derivatives hedging;[8] and that between $21 trillion and $30 trillion had been stashed away in tax havens by the global super-rich, which could not have happened without banks' assistance. In 2013, an emerging issue included JPMorgan Chase's and Barclays' alleged manipulation of prices in energy markets, which was part of the regulatory concern with banks' role in the trading and delivery of commodities generally.[9] And at the end of 2013, the U.S. Department of Justice announced yet another investigation, this one involving alleged manipulation of the foreign exchange market by a group of bankers who called themselves "the cartel," within Citigroup, Barclays, Royal Bank of Scotland, UBS, and Deutsche Bank.[10]

If even some of these charges are true, people in elite, global, too-big-to-fail ("TBTF") banking entities have harbored and assisted global criminal conspiracies and enabled tax evasion on a staggering scale, even as their core functions continue to have the potential to produce unexpected, outsized financial risk. So damaging have these revelations been that the banking public relations machine, led until 2012 by JPMorgan's Jamie Dimon, has been knocked off stride, at least temporarily.[11] Opinions were

6. *See* Jean Eaglesham & David Enrich, *Libor Probe Expands to Bank Traders*, WALL ST. J. (July 24, 2012, 11:38 AM), http://online.wsj.com/news/articles/SB10000872396390443295404577545350903902004 (stating that "[e]merging details about traders suggest to investigators a widespread conspiracy that continued for several years and cascaded around the world," involving traders in at least 16 financial institutions).

7. *U.S. Vulnerabilities to Money Laundering, Drugs, and Terrorist Financing: HSBC Case History: Hearing Before the Permanent Subcomm. on Investigations of the Comm. on Homeland Sec. and Governmental Affairs U.S.S.*, 112th Cong. 2–7 (2012) (statement of Sen. Carl Levin, Member, Comm. on Homeland Sec. and Governmental Affairs), *available at* http://www.gpo.gov/fdsys/pkg/CHRG-112shrg76061/pdf/CHRG-112shrg76061.pdf.

8. Jessica Silver-Greenberg, *JPMorgan Says Trading Loss Tops $5.8 Billion; Profit for Quarter Falls 9%*, N.Y. TIMES DEALBOOK (July 13, 2012, 7:12 AM), http://dealbook.nytimes.com/2012/07/13/jpmorgan-reports-second-quarter-profit-of-5-billion-down-9 (stating that, notwithstanding this loss in synthetic derivatives hedging, JPMorgan Chase had overall second quarter profits of $5 billion). The import of the loss was its unexpected nature, that it caused a restatement of the firm's first quarter results, and that it could occur notwithstanding JPMorgan Chase's compliance and risk management systems, which were considered the best in the business. *Id.*

9. On Chase's and Barclays' alleged manipulation of energy markets, see *infra* notes 138 and 140. On concerns with banks' role in commodities trading, see David Kocieniewski, *A Shuffle of Aluminum, But to Banks, Pure Gold*, N.Y.TIMES, July 21, 2013, at A1 (discussing Congress's growing awareness of problems being caused by banks and their subsidiaries being major participants in commodities trading); *see generally* Saule T. Omarova, *The Merchants of Wall Street: Banking, Commerce, and Commodities*, 98 MINN. L. REV. 265 (exploring banks' roles in commodities trading, including by taking physical delivery).

10. Ben Protess et al., *U.S. Investigates Currency Trades by Major Banks*, N.Y. TIMES DEALBOOK (Nov. 14, 2013, 9:08 PM), http://dealbook.nytimes.com/2013/11/14/u-s-investigates-currency-trades-by-major-banks/.

11. As of January 2014, Mr. Dimon has remained quiet. JPMorgan Chase spent much of the second half of 2013 negotiating with the federal government over potential criminal charges in the mortgage-backed

expressed on both sides of the Atlantic that it is time to reinstate Glass–Steagall's separation of commercial and investment banking;[12] that the Volcker Rule limiting proprietary trading by banks and the Vickers Commission's "ring-fencing" of retail banking are insufficient;[13] that investment banks should once again be required to be private partnerships;[14] that it is time to look more carefully at alternative banking systems, such as co-ops and ethical banks;[15] and that the TBTF banks need to be broken up.[16] Astonishingly enough, Sandy Weill publicly expressed that last opinion in late July 2012, even though Weill was an architect of the Citigroup series of mergers that was the *coup-de-grace* to Glass–Steagall in 1999, and which ushered in today's era of TBTF universal banks.[17]

These developments portend further regulatory interventions to reform finance on

securities market. *See* Ben Protess & Jessica Silver-Greenberg, *Prosecutors and F.B.I. Examine JPMorgan Over Losses*, N.Y. TIMES DEALBOOK (Aug. 11, 2013, 9:25 PM), http://dealbook.nytimes.com/2013/08/11/prosecutors-eye-penalties-over-trading-at-jpmorgan-chase (discussing that criminal investigations were ongoing with no invitation of settlement). Ultimately, JPMorgan ended up paying $13 billion to settle those claims and paying an additional $1.7 billion to settle charges of violations of the Bank Secrecy Act in relation to its prime banking relationships with Bernie Madoff. Yet Mr. Dimon's compensation rose 74% for 2013 to $20 million. Peter Eavis, *Big Raise for JPMorgan's Dimon Despite a Rough Year*, N. Y. TIMES DEALBOOK (Jan. 24, 2014, 12:29 PM), http://dealbook.nytimes.com/2014/01/24/dimons-pay-jumps-to-20-million-in-a-year-of-legal-woes-for-jpmorgan-chase.

12. *See* Luigi Zingales, *Why I Was Won Over By Glass-Steagall*, FIN. TIMES (June 10, 2012, 8:16 PM), http://www.ft.com/intl/cms/s/0/cb3e52be-b08d-11e1-8b36-00144feabdc0.html#axzz2v1VmggP1 (advancing several arguments about the propriety of mandatory separation). Among the arguments University of Chicago Professor Zingales makes is that "Glass–Steagall helped restrain the political power of banks" because commercial banks, investment banks, and insurance companies had different political agendas under Glass–Steagall, and so lobbied for different positions. *Id.* Now, he argues, the industry has "disproportionate power in shaping the political agenda." *Id.*

13. *See* Patrick Jenkins, *Bank Investors Should Push for Simplicity*, FIN. TIMES (July 23, 2012), http://www.ft.com/intl/cms/s/0/d005b01e-d4df-11e1-b476-00144feabdc0.html#axzz2v1VmggP1 (Prompted by the Barclays' [Libor] debacle, a fresh debate has sprung up in political circles and among some bank analysts over the merit of going further than the UK–US axis of Vickers and Volcker and forcibly splitting up universal banks.") Jenkins, the Financial Times' banking editor, found this proposal to have merit. *Id.*

14. *See* Patrick Jenkins, *Banks, The Historical and the Ethical*, FIN. TIMES (July 16, 2012, 6:55 PM), http://www.ft.com/intl/cms/s/0/114f817c-cf53-11e1-a1ae-00144feabdc0.html#axzz2uX13owYd (suggesting that "the ethics of banking are broken").

15. *See id.* (noting that banking "culture" has been criticized). Jenkins notes that there is promise in the Co-operative Bank, "which prides itself on ethical values," preparing to take over 600 Lloyds branches and "tripling its size in the process." *Id.* Given that agenda, Jenkins ends with a question: "Might the balance of power be shifting towards ethical banking?" *Id.* As Part V of this Article discusses, there are a number of reasons to hope the answer to that question is "yes." *See infra* Part V (discussing the Equator Principles).

16. *See* Sebastian Mallaby, *Breaking Up Banks Will Win Investor Approval*, FIN. TIMES (July 17, 2012, 8:08 PM), http://www.ft.com/intl/cms/s/0/db154ff6-cf4d-11e1-a1ae-00144feabdc0.html#axzz2rvec2G3D (arguing that "[t]he promises of synergies trotted out by empire-building bosses in the 1990s have proved largely empty," and that "imperial overstretch is everywhere"). Quoting one investment analyst to the (inelegant) effect that "[b]anks are increasingly regarded as unanalysable and uninvestable," Mallaby concludes that it would be in shareholders' best interests to break up the banks, just as large 1960s conglomerates were broken up to unlock shareholder value. *Id.*

17. Tom Braithwaite & Shahien Nasiripour, *Ex-Citi Chief Weill Urges Bank Break-Up*, FIN. TIMES (July 25, 2012, 4:05 PM), http://www.ft.com/intl/cms/s/0/feaa9cf0-d65f-11e1-ba60-00144feabdc0.html#axzz2rvec2G6D.

both sides of the Atlantic. Yet, given market participants' propensity to engage in regulatory arbitrage, one can feel a bit pessimistic about the ability of regulation alone to wring excessive leverage, fragility, and risk out of the banking system. Indeed, as this essay was being written, the *New York Times* was reporting on a new fund, called the Ovid Regulatory Capital Relief Fund, that is investing in "capital relief trades" or "regulatory capital trades" that allow banks to shift assets off their books by buying credit default swaps being sold by the Fund.[18] Even without regulatory arbitrage, the risk-adjusted capital adequacy requirements at the core of the prevailing international banking standards (Basel II and III)[19] require banks to make good faith determinations of the kinds of risks to which their loans and investment portfolio give rise, and there is widespread concern that these determinations can be manipulated.[20] And even if the banks do act in good faith, the leverage ratio of Basel III, requiring equity of at least 3% of total assets, will not go into effect until January 1, 2019, and this leverage ratio has already been called "outrageously low" by prominent academic critics.[21]

New regulations may well be necessary, but our argument in this Article is that they are not likely to be sufficient without changes within the culture of TBTF financial institutions. Therefore, rather than evaluating specific regulatory proposals that are now on the table, this Article will focus instead on another piece of the reform puzzle: the culture within the financial institutions themselves, particularly the global entities that are explicitly or implicitly TBTF. We will explore approaches to regulation that might affect that culture. We do so with some trepidation, not only because it is not obvious at the outset how deeply firm cultures can be influenced by outside factors such as regulation, but also because "culture" as the problem within financial firms seems to be something of a reformist fad.

In the wake of the Libor (London inter-bank overnight rate) scandal, the UK Parliament has established a Parliamentary Commission on Banking Standards, which is

18. Susanne Craig, *Seeking Relief, Banks Shift Risk to Murkier Corners*, N.Y. TIMES, Apr. 11, 2013, at B1. This trade is structured as were mortgage-backed securities (MBS) trades before the crisis, when firms bought credit default swap (CDS) protection from AIG to enhance the ratings for their MBS. When asked how these new capital relief trades differ from those that "got AIG into trouble," one consultant suggested that the new protection sellers had "done 'a great deal' of due diligence on the underlying collateral, something he said A.I.G. often didn't do." *Id.* at B5. While this due diligence may somewhat reduce the risks from the CDS protection seller's perspective, these trades will still (a) allow banks to take on more leverage than Basel II or III permit and, therefore, undermine the stability in the banking industry that regulatory capital policies seek to promote; (b) increase connections between banks and non-bank entities, raising the risk of contagion; and (c) have the potential to concentrate risk within institutional investors, such as pension funds, that become investors in these regulatory capital funds.

19. Basel II and III are, respectively, the current (2004) and pending accords on capital adequacy agreed upon by the Basel Committee on Banking Supervision, a private transnational standard-setting body. *See* CHRIS BRUMMER, SOFT LAW AND THE GLOBAL FINANCIAL SYSTEM: RULE MAKING IN THE 21ST CENTURY 75–77 (2012) (summarizing the historical events that led to the organization of the Basel Committee, which was established "to both supervise cross-border activities of banks and strengthen the resilience of the international banking system as a whole").

20. ANAT ADMATI & MARTIN HELLWIG, THE BANKERS' NEW CLOTHES: WHAT'S WRONG WITH BANKING AND WHAT TO DO ABOUT IT 184 (2013) ("Banks have developed various techniques for 'risk-weight optimization,' that allow them to choose investments that are in fact riskier than the supervisors believe . . . .").

21. *Id.* at 177.

investigating professional standards and culture in the UK's banking industry.[22] The year 2013 started with the CEO of UBS, Andrea Orcel, telling that Commission that UBS was overhauling its culture and "was 'serious about putting integrity over profit.'"[23] This admission was prompted by a number of problems at UBS: its role in Libor manipulation (18 employees involved have been fired and an additional 40 others disciplined); its failures in risk oversight leading to losses of $38 billion in credit derivatives in 2008 and $2.3 billion from rogue trader Kweku Adoboli; and its having to pay a $780 million fine to U.S. authorities for its role in assisting tax evasion by some of its wealthy clients.[24] UBS was followed by Barclays, which was centrally implicated in both Libor manipulation and insurance mis-selling in the UK.[25] Bob Diamond lost his job as CEO over those scandals, and the new CEO, Antony Jenkins, quickly acted to set a more ethical tone at the top, writing a "stern e-mail" to all employees in an effort that one editorial writer described as a "strong start to reforming the bank's culture," while recognizing that "as Barclays' recent history shows, the problem with values statements is making them stick."[26] Barclays then engaged the prominent British solicitor, Sir Anthony Salz, to conduct an independent review of its business practices (the "Salz Review"), and published the results. That review, emphasizing that the problems "faced [at] Barclays [were] to some extent industry problems—though Barclays should take no comfort from this," included both a chapter on Barclays' culture and an Appendix on what culture is and how it can go wrong.[27]

Yet firm "culture" is more than this season's buzzword, and we think it is an important factor in either undermining or enhancing the efficacy of regulation. In considering how regulation might affect and be affected by firm culture, this Article is informed by the perspectives of anthropology, organizational and social psychology, and new governance regulatory theory. Anthropologists now study corporate culture much as they used to study cultures of far-flung Pacific Islands: by participant observation and fine-grained interpretive analyses. Their work has started to develop a picture of what life is like inside Wall Street or City institutions. The perspective from organizational psychology on which we rely is nicely summarized by Jonathan Haidt: "Moral systems are interlocking sets of values, virtues, norms, practices, identities, institutions, technologies, and evolved psychological mechanisms that work together to suppress or regulate selfishness and make cooperative social life possible."[28] As will be discussed below, a number of theories in social psychology and new governance theory can be used to develop insights into regulatory approaches that might better harness cooperative, pro-social orientations of the people within banking.

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22. *Parliamentary Commission on Banking Standards*, UK PARLIAMENT, http://www.parliament.uk/bankingstandards (last visited Jan. 30, 2014).

23. Patrick Jenkins & Lina Saigol, *UBS's Orcel Admits Banks Must Change*, FIN. TIMES (Jan. 9, 2013, 7:39 PM), http://www.ft.com/intl/cms/s/0/cb3e52be-b08d-11e1-8b36-00144feabdc0.html#axzz2v1VmggP1.

24. *Id.*

25. Philip Augar, *The Cost of Making Bankers Behave*, FIN. TIMES (Jan. 28, 2013, 5:46 PM), http://www.ft.com/intl/cms/s/0/9ea3071a-6639-11e2-b967-00144feab49a.html#axzz2v1VmggP1.

26. *Id.*

27. Sir Anthony Salz, *Salz Review: An Independent Review of Barclays' Business Practices*, WALL ST. J. ONLINE (Apr. 2013), http://online.wsj.com/public/resources/documents/SalzReview04032013.pdf.

28. Jonathan Haidt & Selin Kesebir, *Morality*, *in* 2 HANDBOOK OF SOCIAL PSYCHOLOGY 797, 800 (Susan T. Fiske et al. eds., 5th ed. 2010) (citation omitted).

This Article will proceed as follows: first, Section II discusses business anthropology and the notion of corporate culture as a general background to the analysis that follows. Section III describes the current state of institutional culture in the TBTF financial entities, making clear just how difficult a challenge it would be to incorporate a more pro-social culture into banking. Part IV summarizes a number of research results from organizational psychology that support the hypothesis that the efficacy of regulation can be enhanced by attending to psychological and organizational factors. One implication of that hypothesis is that we can expect some aspects of transnational private regulation, or "soft law," to lead to deeper engagement with the values and goals of a particular regulatory instrument than a traditional "hard law" approach.[29] Part V presents one example from global banking, the Equator Principles (EPs), a widely studied public–private regulatory initiative that imposes social and environmental requirements on borrowers and lenders in the project finance sector.[30] Weaving these strands of prior research together, Part VI offers suggestions for reform that have structural, accounting, and cultural elements. Part VII concludes by discussing a number of criticisms that can be anticipated in reaction to these suggestions, with our responses.

II. THE ANTHROPOLOGY OF CORPORATE CULTURE

"Corporate culture" has become a ubiquitous term, a label for just about everything on the "soft" side of business analysis. When something cannot be explained by numbers, it is attributed to corporate culture. In this sense, the term has come to refer to established ways of doing something within a company, or a part of a company, that seem driven by tradition, habit, group psychology, or history. Such cultural ways of doing things may or may not be consistent with the practices that economic rationality would seem to dictate. In fact, sometimes the term is applied specifically to practices that seem to contradict economic prescriptions, as when business people speak of "norms" in opposition to quantifiable explanations for behavior.

But this is not to say that corporate culture is not real. The anthropological study of corporations as cultural entities has a substantial and growing pedigree.[31] To an anthropologist, culture is the set of shared norms, beliefs, and practices that define a social group's way of life, the mental map that guides individual members of the group through the otherwise baffling complexity of daily life. In the economic sphere, anthropologists "have drawn attention to the practices, rituals, beliefs, and political motivations of the people who self-consciously create and maintain the institutions that engender the market."[32] To contemporary anthropologists, culture is more of a toolkit, a network of resources, than a body of deterministic rules or constraints. A group of people is said to share a cultural perspective when their responses to stimuli—whether an eclipse

29. *See* Deborah E. Rupp & Cynthia A. Williams, *The Efficacy of Regulation as a Function of Psychological Fit: Reexamining the Hard Law/Soft Law Continuum*, 12 THEORETICAL INQUIRIES L. 581, 585 (2011) (arguing for the efficacy of such an integrative process) (citation omitted).

30. Project finance is private lending for large infrastructure projects. *See* Paul M. Vaaler et al., *Risk and Capital Structure in Asian Project Finance*, 25 ASIA PAC. J. MGMT. 25, 26 (2008) (defining typical allocations of risk and capital structure in project finance).

31. For a review of some of this work, see ANNELISE RILES, COLLATERAL KNOWLEDGE: LEGAL REASONING IN THE GLOBAL FINANCIAL MARKETS 11–14 (2011).

32. *Id.* at 14 (internal citation omitted).

of the sun or an opportunity to participate in a shady financial transaction—draw on similar resources and follow roughly similar patterns. Finally, the shared beliefs and practices that identify a culture are usually in a state of negotiation, contestation, and resistance. Change, or at least the prospect of change, is a part of the cultural status quo.

A few examples will illustrate the anthropological approach to business culture. All involve ethnography, anthropology's basic method. It employs participant observation, "a sustained and engaged form of study based on relations of trust with one's subjects, often over long periods of time."[33] An ethnographer traditionally lives among the subjects, observing while participating in their daily lives, and conducting wide-ranging interviews, all in an effort to see the world through their eyes. The method is intensive, fine-grained, qualitative, and unapologetically interpretive, and its ultimate goal is "thick description" rather than grand explanatory theory, what Clifford Geertz called an "ant's eye view" as opposed to a "bird's eye view."[34] While ethnography's roots lie in the study of Pacific Islands, African and Native American communities, and other small-scale societies, it has proven adaptable to the study of the contemporary business world.

One early exercise in financial anthropology involved a study of large pension funds as institutional investors.[35] The study revealed that even in these multi-billion dollar entities, decisions were driven more by factors such as company traditions, the expressed values of leaders, and even the corporate equivalent of "creation myths" than by rigorous financial analysis. In fact, finance itself emerged as a kind of cultural practice that varied from setting to setting, with financial analysis as one of its constituent rituals.

More recently, Karen Ho examined the day-to-day workplace culture of Wall Street firms, with a particular focus on downsizing and restructuring.[36] Ho began pursuing the topic as an employee of Bankers Trust, where, six months into her tenure, she was "canned."[37] She was then called back to work as a "collaborator" or "fellow axe man" in another downsizing project, and ultimately followed up this unusual participant observation with a more formal interview study.[38] Ho became intrigued with what she calls "the cultural production of liquidation,"[39] in particular the ways in which Wall Street culture creates models for corporate restructuring that are exported to the broader economy. The larger point is that the intensive, "ant's eye" examination of an ostensibly high-level economic phenomenon like "corporate restructuring" can reveal deeper and different realities, including the ways in which such practices are propagated into the broader economy. Ho's work is directly relevant to our topic, and we discuss it in more detail below.[40]

A similar focus on mundane, taken-for-granted details is central to Annelise Riles's study of the use of collateral in international finance. As Riles aptly puts it, "[t]he starting

33. *Id.* at 11.

34. CLIFFORD GEERTZ, THE INTERPRETATION OF CULTURES 23 (1973).

35. WILLIAM M. O'BARR & JOHN M. CONLEY, FORTUNE AND FOLLY: THE WEALTH AND POWER OF INSTITUTIONAL INVESTING (1992).

36. *See generally* KAREN HO, LIQUIDATED: AN ETHNOGRAPHY OF WALL STREET (2009) (explaining how financial markets are constructed through the restructuring of corporations and the larger economy).

37. *Id.* at 15.

38. *Id.* at 16.

39. *Id.* at 4.

40. *See infra* notes 54–55 and accompanying text (describing the culture of employment that characterizes Wall Street with detailed first-hand examples).

premise of an anthropological approach is that markets are not abstract machines to be reduced to a few equations or theorems, but messy contexts, full of contradictory forces and elements, actors, languages, institutions, ways of living and knowing."[41] To a lawyer or economist studying markets, "collateral" will be a well-defined technical detail that everyone is assumed to understand. But for Riles, it becomes a problem that is itself worthy of investigation, one of "a set of routinized but highly compartmentalized knowledge practices" that actually comprise global financial governance.[42] Our argument here is similar: to understand recent banking scandals, and to propose reforms that have a chance to succeed, one must understand—from the "ant's eye view"—the "messy contexts, full of contradictory forces and elements."[43] That is, one must understand banking culture and use that understanding to one's advantage in improving banks' institutional behavior.

III. The Current State of Financial Institution Culture

There are a number of influences within global, complex TBTF financial institutions that can normalize behavior that has the potential to create excessive social risk. All are cultural in nature, or at least have a strong cultural component. First is the very notion of "too big to fail," and the implicit and explicit government guarantees that notion implies. Second is the atmosphere of insecurity and market-driven churning among employees. And third is the structure of compensation, particularly within the investment banking sub-culture.

A. The Too-Big-to-Fail Problem

Five general concerns have been identified with continuing to permit TBTF banks to exist. First is moral hazard: actors within TBTF entities may be encouraged to take on excessive risk, often in the form of high levels of bank borrowing ("leverage"), in expectation of government bailouts.[44] Second, credit rating agencies give TBTF entities higher credit scores because of the expectation of government bailouts than they would without that backstop, which distorts TBTF banking entities' cost of capital and leads to an unfair competitive advantage.[45] This advantage, combined with the size of TBTF

41. RILES, *supra* note 31, at 11.

42. *Id.* at 10.

43. *Id.* at 11.

44. *See* ADMATI & HELLWIG, *supra* note 20, at 129–47 (describing the process of bank borrowing); *see generally* Arthur E. Wilmarth, Jr., *The Dodd–Frank Act: A Flawed and Inadequate Response to the Too-Big-to-Fail Problem*, 89 OR. L. REV. 951 (2011) [hereinafter Wilmarth, *Dodd–Frank*] (explaining the inadequacies and flaws of the Act). Professor Wilmarth, of George Washington University, was a member of the Financial Crisis Inquiry Commission established by the U.S. Congress. Professor Wilmarth points out that in 2007, just prior to the financial crisis, the 10 largest financial institutions in America had average leverage ratios of 27:1. *See id.* at 971. For a study of the growth of leverage within American finance prior to the crisis, and the effects of that leverage, see generally Margaret M. Blair, *Financial Innovation, Leverage, Bubbles and the Distribution of Income*, 30 REV. BANKING & FIN. L. 225 (2010–2011). *See also* Arthur E. Wilmarth, Jr., *The Transformation of the U.S. Financial Services Industry, 1975–2000: Competition, Consolidation, and Increased Risks*, 2002 U. ILL. L. REV. 215, 295, 301–02 (citing studies finding that large banks operated with capital ratios that were much lower than those of smaller banks).

45. *See* Wilmarth, *Dodd–Frank*, *supra* note 44, at 983 (internal citation omitted) (discussing Moody's

banks within the economy, leads to the third problem, that of excessive political influence.[46] Fourth, the banks as a sector may become strategically reckless, seeking to "grow fast by expanding their borrowing without seeing their borrowing rates increase" (the rates charged them for the borrowing) because creditors "expect their investments to be safe because of the guarantees."[47] Fifth, there is a corrosive effect on social cohesion when there is a widespread perception that the financial system privatizes gains and socializes losses. Different people will have different reactions to this state of affairs—some angry, some cynical—but in general, it can have the effect of undermining trust in both government and financial institutions.

At the societal level, TBTF must be understood as a market failure; as such, it cannot be solved by market mechanisms,[48] and we have yet to see sufficient regulatory solutions.[49] As an economic matter, TBTF banks may seem stronger than they actually are, benefiting from capital costs that are effectively subsidized by the explicit and implicit government guarantees.[50] This illusion of strength in turn gives rise to allocative inefficiencies. Smaller community banks (up to $10 billion in assets), with superior loan quality, greater resilience during a financial crisis, and higher operating efficiencies than TBTF banks, nonetheless find it difficult to compete for market share.[51] Within the

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upgrades of the credit risk of a number of TBTF banks given what Moody's called the "very high probability of systemic support" from the government for those institutions).

46. For a recent history of this political influence, including debates within the Clinton Administration and the International Monetary Fund during the 1990s concerning deregulation of finance, see MICHAEL HIRSH, CAPITAL OFFENSE: HOW WASHINGTON'S WISE MEN TURNED AMERICA'S FUTURE OVER TO WALL STREET 103–21, 305–22 (2010). For critical commentary, see JACOB S. HACKER & PAUL PIERSON, WINNER-TAKE-ALL POLITICS: HOW WASHINGTON MADE THE RICH RICHER—AND TURNED ITS BACK ON THE MIDDLE CLASS (2010); SIMON JOHNSON & JAMES KWAK, 13 BANKERS: THE WALL STREET TAKEOVER AND THE NEXT FINANCIAL MELTDOWN (2011); JOSEPH E. STIGLITZ, FREEFALL: AMERICA, FREE MARKETS, AND THE SINKING OF THE WORLD ECONOMY (2010).

47. ADMATI & HELLWIG, *supra* note 20, at 145.

48. Professor Simon Johnson, former Chief Economist for the IMF, recounts a colloquy in a Senate Hearing on Libor manipulation in July 2012 between Sen. Sherrod Brown (D-OH) and Federal Reserve Chairman Ben Bernanke. Simon Johnson, *The Federal Reserve and the Libor Scandal*, BASELINE SCENARIO (July 19, 2012), http://baselinescenario.com/2012/07/19/the-federal-reserve-and-the-libor-scandal. Sen. Brown suggested that TBTF is also too big to manage, and Chairman Bernanke agreed that "the real issue is [TBTF]," but that "if banks are really exposed to the discipline of the market, we'll see some breakup" of TBTF banks. *Id.* Professor Johnson's evaluation was that TBTF is a problem that the market cannot solve on its own, precisely because these banks have competitive advantages from their explicit and implicit government subsidies. *Id.*

49. *See generally* Wilmarth, *Dodd–Frank*, *supra* note 44 (noting that the crisis revealed fundamental weaknesses in the financial regulatory systems of the United States). Chairman of the Federal Reserve Bank Board Ben Bernake agreed in testimony on July 18, 2013, that TBTF has yet to be solved, but he said that he would give current regulatory approaches more time to work before considering further regulatory interventions. *Fed. Reserve's Second Monetary Policy Rep. for 2013: Hearing Before the Comm. on Banking, Housing, and Urban Affairs U.S.S.*, 113th Cong. 24–26 (2013) (statement of Ben S. Bernanke, Chairman, Board of Governors of the Fed. Reserve Sys.) (colloquy with Sen. Elizabeth Warren), *available at* http://fraser.stlouisfed.org/docs/historical/senate/cmp/2000s/CHRG-113shrg82735.pdf.

50. *See* ADMATI & HELLWIG, *supra* note 20, at 144 (noting that the banks are not generating more value, but simply benefiting from more subsidized funding).

51. *See Dallas Fed Advocates 'Back-to-Basics' for Banking Industry*, FED. RESERVE BANK DALLAS, http://www.dallasfed.org/news/releases/2013/nr130117.cfm (last visited Mar. 5, 2014) (analyzing locally owned community banks in the United States with assets up to $10 billion and finding that they "weathered the financial crisis with relatively high loan quality compared with larger financial institutions").

TBTF banks—implicit and explicit government guarantees and subsidies have led to cultures that are prone to excessive risk-taking and speculation—what the Salz Review described as a winning "at all costs" attitude in an atmosphere suffused with "rivalry, arrogance, selfishness and a lack of humility and generosity."[52]

B. A Culture of Insecurity

The second feature of life within global TBTF financial institutions—particularly on their trading floors and in investment banking generally—is the volatility of employment and the insecurity that it can create, particularly at lower and middle levels. As described above,[53] anthropologist Karen Ho did field work on Wall Street by getting a job at an investment bank and then finding herself downsized. That experience allowed her both to observe and to participate in the brutal culture of employment that characterizes Wall Street, a culture that investment bankers have exported to corporate America through their efforts to sell their clients on serial acquisitions, divestment, reorganizations, mergers, and consolidations. As one of her informants described it, echoing the sentiments of many:

> I think that every single day you realize that your job could be gone the next day. You have a downturn in the market and they lay off hundreds of people or you have a downturn in just your desk['s] [particular product area] performance; all of sudden they need to lay off people. Your company decides they don't want to be in that product anymore; they lay off an entire department. I just think that's part of life here.[54]

Not only is employment volatile, but it is subject to daily accountability by the only metric that matters on Wall Street: how much money have you made for me today? As one of Ho's informants put it, "I didn't realize just how short-sighted they were at that point. They are literally; it is all about today and it's whether you can make money today and if you can't make money today, you are out of there."[55] Finally, these sackings are public: a flotilla of people from human resources march onto the floor with cardboard boxes and tap people who are losing their jobs on the shoulder. The message is: pack up and get out.[56] Colleagues also receive a message: this could be you next time. The environment is one of fear, insecurity, and potential humiliation. That environment has endured because of the possibility of great economic rewards for the winners, but with the consequence that survival at any cost becomes the dominating motivation for many participants.

52. Salz, *supra* note 27, at 82.

53. *See supra* notes 36–38 and accompanying text (describing Karen Ho's tenure as an employee of Bankers Trust).

54. Karen Ho, *Disciplining Investment Bankers, Disciplining the Economy: Wall Street's Institutional Culture of Crisis and the Downsizing of "Corporate America"*, 111 AM. ANTHROPOLOGIST 177, 182 (2009) (citation omitted).

55. *Id.* (citation omitted).

56. *See* MARGIN CALL (Benaroya Pictures 2011) (depicting the procedure of firings on Wall Street at the beginning of the crisis). The accuracy of the scene has been substantiated by our own informants in Wall Street investment banks.

C. Compensation Structures that Exalt Risk and Self-Interest

Much has been written about the problems of bankers' compensation. From a social risk perspective, the problem with executive compensation in banking arises from at least two factors. First, there has been a shift in banking from an "originate-and-hold" approach to lending to an "originate-to-distribute" model that relies on securitization of loans.[57] In the latter approach, bank fees and bankers' performance-based compensation are increased by the volume of transactions. The shift to this approach has increased the cumulative risk in the global financial system, because the distribution of credit risk via securitization has undermined the banks' incentives to be as rigorous in credit evaluation as they would have been in the "boring" old world of originate-and-hold banking.[58] The economic self-interest of bankers under this new model—which lies in maximizing transactions and bank fees—thus directly conflicts with the goals of prudence and global systemic stability.

Second, the sheer scale of bankers' compensation allows bankers (and the banks for which they work) to exercise a disproportionate influence in the political arena, both through campaign contributions and lobbying. This disproportionate influence is particularly a problem in the United States, where legislative restraints on corporations' use of their funds for electioneering were declared unconstitutional by the United States Supreme Court in 2010.[59] As stated by the Financial Crisis Inquiry Commission, "from 1999 to 2008, the financial sector expended $2.7 billion in reported federal lobbying expenses; individuals and political action committees in the sector made more than $1 billion in campaign contributions."[60] A number of analyses of the influence of the finance industry on economic policy in the United States have recognized that influence as a serious problem as bankers' interests and financial contributions to campaigns constrain policy choices.[61] Of course, it is not only in the United States that policy choices have become constrained by bankers' power. In the EU and U.K., policies of economic austerity have been implemented at the behest of "financial market traders" to address the government debt taken on to bail out the banks, even though austerity is likely to further undermine macroeconomic performance.[62]

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57. *See* TREASURY COMMITTEE, FINANCIAL STABILITY AND TRANSPARENCY (2007–08), H.C. 6, at 18–20 (illustrating early discussions of this transition); *see also* Lord Adair Turner, *The Turner Review: A Regulatory Response to the Global Banking Crisis*, FIN. SERVICES AUTHORITY 16, 43 (2009), http://www.fsa.gov.uk/pubs/other/turner_review.pdf (analysing the financial crisis, including the transition in banking).

58. *See generally* Lucian A. Bebchuk & Holger Spamann, *Regulating Bankers' Pay*, 98 GEO. L.J. 247 (2010) (restating the moral hazard problem in banking and discussing factors that exacerbate the problem, ultimately recommending regulation of bank executives' pay as an "element of financial regulation"); Yoram Landskroner & Alon Raviv, *The 2007–2009 Financial Crisis and Executive Compensation: An Analysis and a Proposal for a Novel Structure*, SSRN (Sept. 15, 2009), http://www.ssrn.com/abstract=1420991 (analyzing executives' incentives to take risks in good economic times).

59. Citizens United v. Fed. Election Comm'n, 130 S. Ct. 876, 886 (2010).

60. FIN. CRISIS INQUIRY COMM'N, THE FINANCIAL CRISIS INQUIRY REPORT xviii (2011), *available at* http://fcic-static.law.stanford.edu/cdn_media/fcic-reports/fcic_final_report_full.pdf.

61. *See generally* HACKER & PIERSON, *supra* note 46; JOHNSON & KWAK, *supra* note 46.

62. Suzanne Konzelmann, *The Political Economics of Austerity*, CAMBRIDGE J. ECON. (manuscript at 31) (forthcoming 2014) (providing an intellectual history of arguments for austerity within Western politics and economic theory since the 17th Century and connecting that history to the political economy of austerity

Within individual banks the scale of compensation in conjunction with the insecurity of employment work to promote a "get it while the getting is good" mentality. This then leads to a frantic and unending search for deals, trades, and volume of transactions. Since individual financial contribution—itself based largely on volume of transactions—is the "overwhelming determinant of discretionary bonuses" within many TBTF financial institutions,[63] a hyper-competitive, individualistic culture is almost an inevitable result. In such an atmosphere, risk management and legal compliance can come to be seen as unnecessary grit slowing down deal flow.

IV. INSIGHTS FROM ORGANIZATIONAL PSYCHOLOGY

In addition to these general conditions that foster a culture of risk, there are examples of more specialized units within banking that have demonstrated particularly pernicious behavior. One extreme example is the Structured Capital Markets (SCM) group within Barclays' investment banking group, a group which new CEO Antony Jenkins disbanded after the Salz Review. The SCM group was established to develop and promote tax avoidance techniques for corporate clients. Although it endeavored to develop *legal* tax avoidance strategies, the Salz Review indicated that the group became increasingly aggressive about its work and hostile to tax authorities.[64] The Guardian newspaper paints an extraordinary picture:

> Whistleblowers described to us a management style that depended on fear, summary sackings, ritual humiliations and group social events that outdid any 1980s fictional tales of macho banking excess. . . . On one occasion a secretary was said to have been fired for booking an executive a taxi that was a Volvo rather than an S class Mercedes. Team-building events included free-flowing champagne and cigars, poker games involving hundreds of thousands of pounds in bets and a "motivation" exercise in which an executive was strapped to a mock electric chair to the soundtrack of a rap song with the line "I hate you and I hope you die."[65]

In a comprehensive review of the literature on behavioral ethics in organizations, Treviño, Weaver, and Reynolds suggest a number of reasons why such pathological work-groups can develop.[66] First, research in accountancy has shown that managers and partners in public accounting firms generally "have lower moral reasoning scores than those at lower organizational levels in the firm."[67] We can hypothesize that client-driven

measures in Europe and the U.K. today, which measures the author finds flawed as a matter of economic theory).

63. Salz, *supra* note 27, at 130.

64. *Id.* at 68–75.

65. Felicity Lawrence, *Barclays Secret Tax Avoidance Factory that Made £1bn A Year Profit Disbanded: Lucrative Dark Arts Were Practiced in the Run-Up to the Banking Crisis by the Company's Structured Capital Markets Division*, THE GUARDIAN (Feb. 11, 2013, 2:33 PM), http://www.theguardian.com/business/2013/feb/11/barclays-investment-banking-tax-avoidance. The Guardian was preparing to publish news reports on this group in 2009 based on interviews with whistleblowers and documents provided to it. *Id.* Barclays obtained an injunction against publication, but the injunction was lifted after a parliamentary reference to the material. *Id.*

66. Linda K. Treviño et al., *Behavioral Ethics in Organizations: A Review*, 32 J. MGMT. 951, 956 (2006).

67. *Id.* (citing L. Ponemon, *Ethical Reasoning and Selection-Socialization in Accounting*, 17 ACCT.,

professions such as accounting, law, and finance will put pressure on individuals to identify more closely with clients as they take on more responsibility in the firm, and to minimize the moral quandaries clients' behavior may occasion. Second, while people's self-identity as moral agents and their cognitive evaluations of the morality of situations clearly have an effect on their behavior, so do organizational contexts. "Overt on-the-job pressures to act unethically clearly have an impact,"[68] as do unmet organizationally defined goals, especially where an individual employee is "just slightly removed from the achievement of a goal."[69] Other contexts that can encourage unethical behavior include situations of "moral muteness," where practices and language within the firm, particularly among those people with whom a person works closely, do not recognize moral dilemmas. Finally, "[o]rganizational cultures and practices also can normalize unethical behavior."[70] Ashforth and Anand describe this process as "one of initial cooptation of newcomers, incremental increases in unethical behavior by the newcomer (leading to changes in attitude), and repeated moral compromises that similarly bring about ultimate attitude change."[71]

A. Developing Organizations that Promote Ethical Behavior

But organizational and social psychology resists the view that such trajectories are inevitable. Empirical and theoretical research in psychology shows three kinds of human motives for action: (1) instrumental motives, such as self-interest, which are based on the psychological need for control of one's life and environment; (2) relational motives, which are based on the need to belong to groups (such as families, firms, industries, and countries); and (3) moral motives, which are based on the need for a meaningful existence.[72] Although the notion of self-interested *homo economicus* has dominated "social science theory in the past decades,"[73] a more realistic picture of the person shows that human behavior is influenced by multiple motives, not only self-interest.[74] The

ORGS. & SOC'Y 239 (1992)) (examining the ethical reasons of CPAs in professional practice).

68. Treviño et al., *supra* note 66, at 965 (citing D.C. Robertson & T. Rymon, *Purchasing Agents' Deceptive Behavior: A Randomized Response Technique Study*, 11 BUS. ETHICS Q. 455 (2001)) (examining the influence of organizational variables on the behavior of purchasing agents toward their sellers).

69. Treviño et al., *supra* note 66, at 965 (citing M.E. Schweitzer et al., *Goal Setting as a Motivator of Unethical Behavior*, 47 ACAD. MGMT. J. 422 (2004)) (finding that people with unmet goals will be more likely to engage in unethical behavior regardless of economic incentive).

70. Treviño et al., *supra* note 66, at 968.

71. *Id.* (citing Blake E. Ashforth & Vikas Anand, *The Normalization of Corruption in Organizations*, 25 RES. ORG. BEHAV. 1, 3 (2003)).

72. *See generally* Russell Cropanzano et al., *Three Roads to Organizational Justice*, 20 RES. PERSONNEL & HUM. RESOURCES MGMT. 1 (2001) (describing decades of theoretical and empirical research into types of human motives, and discussing how those motives advance or impede productive organizations and employee engagement). The research also shows that many human actions are motivated by mixtures of instrumental, relational, and moral motives, such as a person acting out of benevolent regard for a member of their own family or group. *Id.*

73. *See, e.g.*, Rupp & Williams, *supra* note 29, at 582 (citing DAVID M. HOLLEY, SELF-INTEREST AND BEYOND (1999)).

74. *See generally* Russell Cropanzano et al., *Self-interest: Defining and Understanding a Human Motive*, 26 J. ORG. BEHAV. 985, 986 (2005) (taking a multi-disciplinary perspective in arguing that other motives exist beyond self-interest).

social sciences literature shows evidence of individuals acting on the basis of norms,[75] cooperation,[76] fairness,[77] empathy,[78] and moral duty,[79] among other motives. Organizational psychologists have also identified and measured different types of "ethical climates" within firms, defined as "shared perceptions of what is correct behavior, and how ethical situations should be handled in an organization," identifying distinct ethical climates that predominantly emphasize self-interest, caring, independence, rules, or codes of professional behavior and law.[80] This work emphasized the consequences of ethical climates on employees' actions and productivity, including law compliance, more than it studied the antecedents of different ethical climates within firms. However, in light of the financial crisis, some organizational psychologists have called for greater attention to the antecedents of productive, ethical firm climates.[81] Although the task is daunting, we argue that it is not illusory to suggest that banking cultures could be shaped to better advance social as well as individual goals. The social context for action must be structured to encourage other behavior, which social psychology suggests is possible.

Research suggests that all three types of motives (instrumental, relational, and moral) influence people at work as they react to multiple contextual factors, including: the systems of power and influence within which they operate; the transparency of communications within the firm; the quality of relationships with peers and superiors; the opportunities for exercising autonomy, competence, and control; and the structures that enable a secure sense of attachment to, and identification with, the firm's values.[82] An influential psychological theory called "self-determination theory" posits that the optimal human condition is one where individuals develop a sense of positive motivation and responsibility, and the contextual factors that best promote this condition are autonomy, feelings of competence, and relatedness.[83] This is hardly a description of a TBTF financial institution's environment. Could it ever be so?

75. *See* Ernst Fehr & Simon Gächter, *Altruistic Punishment in Humans*, 415 NATURE 137, 140 (2002). One needs to add the qualification that relational motives such as "norms" or "cooperation" can be engaged in either socially productive actions, or in actions that harm society, since many antitrust conspiracies or conspiracies to manipulate Libor, for instance, show strong cooperation among individuals being used to advance the self-interested goals of the participants.

76. *See generally* Gary E. Bolton & Axel Ockenfels, *ERC: A Theory of Equity, Reciprocity, and Competition*, 90 AM. ECON. REV. 166, 167 (2000) (describing how people are influenced by others that cooperate with them to be more cooperative and fair in outcomes).

77. *See generally* Daniel Kahneman et al., *Fairness and the Assumptions of Economics*, 59 J. BUS. 285, 285–86 (1986) (discussing how profit-seeking firms and individuals have an incentive to act fairly).

78. *See generally* C. Daniel Batson, *Prosocial Motivation: Why Do We Help Others?*, *in* ADVANCED SOCIAL PSYCHOLOGY 332 (A. Tesser ed., 1995).

79. *See generally* Carmelo J. Turillo et al., *Is Virtue Its Own Reward? Self-Sacrificial Decisions for the Sake of Fairness*, 89 ORG. BEHAV. & HUM. DECISIONAL PROCESSES 839, 840 (2002) (describing how morality affects human action and takes it out of the realm of self-interest).

80. *See* David M. Mayer, *A Review of the Literature on Ethical Climate and Culture*, *in* HANDBOOK OF ORGANIZATIONAL CLIMATE AND CULTURE (Benjamin Schneider & Karen M. Barbera eds., 2014) (citing Bart Victor & John B. Cullen, *A Theory and Measure of Ethical Climate in Organizations*, 9 RES. CORP. SOC. PERFORMANCE & POL'Y 51–71 (1987)).

81. *See* Mayer, *supra* note 80 (citing Victor and Cullen).

82. *See* Cropanzano et al., *supra* note 72 (explaining how self-interest motivates workplace behavior).

83. EDWARD L. DECI & RICHARD M. RYAN, INTRINSIC MOTIVATION AND SELF-DETERMINATION IN HUMAN BEHAVIOR 35–38 (1985).

B. New Governance and the Development of Productive Culture

We suggest the contextual factors that self-determination theory has identified as important for people's development of positive motivations and responsibility for their actions (autonomy, feelings of competence, and relatedness) are likely to be fostered by some aspects of "soft law" or "new governance" approaches such as transnational private regulation.[84] Whereas hard law means traditional, state-enacted positive law, new governance refers to "softer," often voluntary, governance arrangements that have developed in Western democracies in the last few decades, particularly in response to economic globalization. The diffusion of the responsibility to establish standards of conduct among a variety of governmental and private actors dispersed across networks that transcend national boundaries characterizes soft law.[85]

Self-determination theory shows that external punishment and reward structures can thwart individuals' pursuit of activities for their intrinsic value, the so-called "crowding out" problem.[86] Self-determination theory also supports the view that if people within regulated entities are engaged with regulators or representatives of non-government organizations (NGOs) in developing the voluntary standards for actions, there is a good possibility of creating greater trust between the parties, and a state of shared values and mutual problem-solving that should lead to better compliance with the content of the standards. We must acknowledge caveats, of course. There are a number of interacting variables that will affect the extent to which principles-based or cooperative regulatory approaches achieve their goals, such as the commitment of the top-management team in a firm to those goals and the level of trust between workers and management within the firm.[87] Moreover, financial regulation is addressing issues of such complexity and uncertainty that no one approach to regulation can be expected to be fully successful; new governance approaches will also have flaws.[88] Yet in theory, greater autonomy of industry participants in authoring the standards by which they will act—which is a core feature of new governance approaches—should lead to greater commitment to those

84. *See* Rupp & Williams, *supra* note 29, at 585 (arguing that soft law approaches to the development of standards for business conduct may lead to deeper engagement with those standards' values and goals because of the positive psychological effects of being engaged in their development).

85. The literature on new governance is voluminous. For some excellent starting points, see Colin Scott, *Regulation in the Age of Governance: The Rise of the Post Regulatory State*, *in* THE POLITICS OF REGULATION: INSTITUTIONS AND REGULATORY REFORMS FOR THE AGE OF GOVERNANCE (Jacint Jordana & David Levi-Faur eds., 2004); Orly Lobel, *Renew Deal: The Fall of Regulation and the Rise of Governance in Contemporary Legal Thought*, 89 MINN. L. REV. 343 (2004). For an introduction to the way governments are increasingly working together in non-treaty-based, issue-specific networks (*e.g.*, such as banking or securities regulators working together), see Anne-Marie Slaughter, *Global Government Networks, Global Information Agencies, and Disaggregated Democracy*, 24 MICH. J. INT'L L. 1041, 1048–58 (2003).

86. DECI & RYAN, *supra* note 83, at 38–39. Empirical support of the crowding-out theory is discussed in Bruno S. Frey & Felix Oberholzer-Gee, *The Cost of Price Incentives: An Empirical Analysis of Motivation Crowding-Out*, 87 AM. ECON. REV. 746 (1997); and MICHAEL J. SANDEL, WHAT MONEY CAN'T BUY: THE MORAL LIMITS OF MARKETS 93–130 (2012).

87. *See* Neil Gunningham & Darren Sinclair, *Organizational Trust and the Limits of Management-Based Regulation*, 43 LAW & SOC'Y REV. 865, 867–69 (2009) (discussing the limits of management-based regulation depending on effective management and employee commitment).

88. *See* Cristie Ford, *New Governance in the Teeth of Human Frailty: Lessons from Financial Regulation*, 2010 WIS. L. REV. 441, 483–87 (discussing new governance regulatory theory and how it might better be adapted to the complexity and bounded rationality of both regulators and participants in the financial industry).

standards. We turn to an example in banking that we suggest demonstrates the power of new governance to advance these positive regulatory outcomes, and potentially to affect firm cultures.

V. An Example of New Governance in Action

In a less-publicized corner of global banking, a different picture of bank social responsibility is emerging: an initiative that aims to mitigate the potentially negative social and environmental consequences of infrastructure development in politically unstable or environmentally fragile landscapes. The vehicle for doing this is called the Equator Principles (EPs), which is a voluntary agreement among 79 banks in 35 countries, including such global banks as Barclays, Citigroup, Credit Suisse, HSBC, ING, and RBS.[89] The EPs create social and environmental standards for project finance—the private financing of large, revenue-producing infrastructure projects such as dams, pipelines, and wind farms, constructed by private companies in the developing world. The project finance sector is vitally important because the decisions on whether, how, and on what terms infrastructure projects are undertaken in poorer countries can have tremendous economic, social, and environmental consequences. The EPs commit the participants (the Equator Principles Financial Institutions, or EPFIs) to screening potential projects for social and environmental impact, rejecting those that fall short, and insisting on ongoing and enforceable social and environmental standards for those projects that are financed. Those social and environmental standards rely directly upon those promulgated by the International Finance Corporation (IFC), the private-sector lending division of the World Bank Group.[90] The EPs were first promulgated in 2003, were initially revised in 2006, and were revised again in 2011–12.[91] The latest revised version, EP III, took effect on June 4, 2013.[92] Because the EPs are taken directly from the IFC's Safeguard Policies and Performance Standards, which set out very specific social and environmental requirements, the EPs are revised as the IFC revises its policies and standards.[93] In the first two iterations, the EPs applied only to project finance as defined above. Project finance loans are non-recourse, meaning that lenders are repaid only through the revenues generated by the project. Thus, even if the project sponsor (the

89. *About the Equator Principles*, EQUATOR PRINCIPLES, http://equator-principles.com/index.php/about (last visited Feb. 27, 2014); *see also* John M. Conley & Cynthia A. Williams, *Global Banks as Global Sustainability Regulators?: The Equator Principles*, 33 LAW & POL'Y 542, 542–75 (2011) (reporting on the results of interviews of bankers, scientists, NGOs, and government officials involved in developing and implementing the Equator Principles).

90. For access to the suite of IFC environmental and social policies, performance standards, and reporting requirements, see *About IFC*, INT'L FIN. CORP., http://www.ifc.org/wps/wcm/connect/corp_ext_content/ifc_external_corporate_site/about+ifc (last visited Feb. 27, 2014). These requirements are applied to all IFC lending and investments, as well as to the IFC's advisory work. *IFC's Sustainability Framework*, INT'L FIN. CORP., http://www.ifc.org/wps/wcm/connect/Topics_Ext_Content/IFC_External_Corporate_Site/IFC+Sustainability/Sustainability+Framework (last visited Mar. 21, 2014).

91. *See* Conley & Williams, *supra* note 89, at 545 (discussing revisions to the EPs).

92. *The Equator Principles III—2013*, EQUATOR PRINCIPLES, http://www.equator-principles.com/index.php/ep3 (last visited Feb. 27, 2014).

93. *About Equator Principles (EP III) Update Process and Timeline*, EQUATOR PRINCIPLES, http://www.equator-principles.com/index.php/process-and-timeline (last visited Feb. 27, 2014).

borrower) is financially strong, the lending banks face particularized financial risks from anything in the political or social environment that could threaten completion of a project. The EPs emerged in part as a way to manage these concerns.[94] The recently promulgated EP III apply to a broader set of financial arrangements, including project finance advisory services, project-related corporate loans, and bridge loans in addition to project finance itself.[95]

Academic research on the effects on the ground of the EPs is very limited thus far, so the following observations must be understood in light of that substantial caveat.[96] Nonetheless, there are a number of aspects of the structure and effects of the EPs that suggest approaches to explore in reforming the culture of banking. First, the single most important economic fact about the EPs is that project finance loans are non-recourse, meaning that borrowers repay them (or not) solely from the income their projects generate.[97] Consequently, the project must succeed or the lender will not get its money back. As a result, risk management is a vital concern and a leading motivation for joining the EPs for just about every participating bank.[98] Because every project must be economically self-supporting, borrowers must avoid social and environmental fall-out that might threaten the economic performance of a project. Thus, social, environmental, and human rights risks that normal accounting treats as externalities are internalized. This internalization factor is highly salient when thinking about how better to instantiate positive social actions (and possibly values) within TBTF and other banks.[99]

Second, given the opprobrium heaped on global banks in recent years by politicians, voters, the media, and the NGO community, the reputation management potential of participation in the EPs is also highly valued.[100] The EP project presents itself as an ostensibly benevolent cartel that seems superior both to doing nothing (and perhaps

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94. *See* Christopher Wright & Alexis Rwabizambuga, *Institutional Pressures, Corporate Reputation, and Voluntary Codes of Conduct: An Examination of the Equator Principles*, 111 BUS. & SOC'Y REV. 89, 96 (2006) (discussing banks' motivations for joining the EPs).

95. *Changes Reflecting Priorities and Recommendations from the EP Strategic Review*, EQUATOR PRINCIPLES, http://www.equator-principles.com/index.php/ep3/ep3 (last visited Feb. 27, 2014) (indicating, via chart, that the expanded scope of the EP III coverage in comparison to the EP II coverage with the additional coverage of bridge loans and project-related corporate loans).

96. In contrast, the overall framework of the Equator Principles and its effects on banks and bank lending at the corporate level have been extensively studied. *See generally* Motoko Aizawa & Chaofei Yang, *Green Credit, Green Stimulus, Green Revolution? China's Mobilization of Banks for Environmental Cleanup*, 19 J. ENV'T. & DEV. 119 (2010) (discussing the effects of the Equator Principles on bank lending in China, from the perspective of an IFC employee (Aizawa) and Chinese Ministry of Environment employee (Yang)); Ronen Shamir, *Corporate Social Responsibility: Towards a New Market-Embedded Morality?*, 9 THEORETICAL INQUIRIES L. 371 (2008) (discussing the Equator Principles from a sociological perspective); Heiko Spitzeck, *Organizational Moral Learning: What, If Anything, Do Corporations Learn from NGO Critique?*, 88 J. BUS. ETHICS 157 (2009) (using a longitudinal study of Citigroups's conflict with the Rainforest Action Network and subsequent participation in the Equator Principles to question current theories about how "organizational moral learning" occurs).

97. *See* Rajeev J. Sawant, *The Economics of Large-Scale Infrastructure FDI: The Case of Project Finance*, 41 J. INT'L BUS. STRATEGIES 1036, 1037 (2010) (discussing economic structure of project finance).

98. *See* Conley & Williams, *supra* note 89, at 559–60 (stating that interview subjects identified financial risk management as an important reason to adopt the EPs).

99. *See infra* Part VI (analyzing EPFIs' emphasis on evaluating social and environmental harm).

100. *See* Conley & Williams, *supra* note 89, at 558–59 (noting that interview subjects discuss reputation management as an important reason to adopt the EPs).

inviting hard regulation) and to taking individual action. The EPs permit a bank to manage risk and reputation and fend off prospective regulators, using management approaches that will add (possibly minimal) costs, without worrying about what its competitors are doing. The compliance costs to the borrowers are likely to be more substantial, assuming good-faith implementation. They include the costs of evaluation, monitoring, and annual reporting; environmental mitigation and labor protection; and consulting with indigenous communities, developing dispute resolution procedures, and then addressing any issues that arise within those communities. If only a few banks were requiring these things, they would be at a significant competitive disadvantage and would probably lose customers. If the entire benevolent cartel is requiring them, however, competitive disadvantage is much less of a concern. This point is not to suggest that we need even more cartel-like behavior among the TBTF banks, but rather to highlight the need to conceptualize reform mechanisms that cordon off productive social behavior from the competitive arena, as the EPs do.

Third, notwithstanding the primacy of these self-interested motives, a real and growing commitment to corporate responsibility cannot be dismissed. In particular, many people in participating EP banks perceive the most important effect of the EPs to be the internal changes within the banks that have occurred.[101] Complying with the EPs has increased awareness of sustainability issues within the credit committees in the EPFIs, and some of this awareness has then spilled over into general commercial lending and, in some cases, underwriting.[102] The EPs specifically require that there be outside monitors doing in-depth analysis of social and environmental risks at the planning stages of projects, and those analyses become part of the materials available to and discussed by the credit committees. This increase in the breadth of information being considered may be creating a positive "social contagion" with potential to change the scope of some bankers' thinking about the social implications of their credit decisions.

Can this positive social contagion spread beyond project finance and commercial lending? Perhaps, but so far it seems not to have. In fact, the banks with the strongest evidence of EPs values influencing other commercial lending—HSBC, Barclays, Citigroup, and UBS—are the same banks highlighted in the rogues' gallery at the beginning of this Article.[103] Our intuition is that project finance teams work in a different

101. *See* Aizawa & Yang, *supra* note 96, at 128 (stating that most of the "first-generation EPFIs" credit the EPs with changes within their firms, including "necessitat[ing] a systematic approach to management of environmental and social issues" beyond project finance); Spitzeck, *supra* note 96, at 167 (describing the perspective of a Citibank manager that EPs have had a "stunning impact" on lending practices because prior to participating in the EPs Citigroup "did not have an environmental and risk management policy or system or director"; whereas after joining, it was "much easier to lend money to a wind energy plant than to a coal-fired plant").

102. For example, at HSBC, policies were developed consistent with the Equator Principles for all lending and underwriting in five sectors: chemicals industry; energy; forest land and forest products; freshwater; and mining and metals. *Equator Principles and Sector Policies*, HSBC, http://www.hsbc.com/citizenship/sustainability/sustainability-risk/equator-principles-and-sector-policies (last visited Feb. 27, 2014). At Barclays, a wide range of social and environmental policies now exist, as well as procedures to ensure consistent governance across those policies. *See, e.g.*, *Policy Positions*, BARCLAYS, http://group.barclays.com/about-barclays/citizenship/policy-positions (last visited Feb. 27, 2014).

103. *See supra* note 6 and accompanying text (listing Barclays, Citigroup, UBS, and HSBC as some of the "too-big-to-fail global banks").

cultural context than those in other areas of banking. The ramifications of project finance developments, both positive and negative, are easier to see than those of investment banking or securities trading. This observation emphasizes a point also made in the Salz Review: different parts of TBTF banks exhibit different cultures.[104] In our suggestions for reform, we discuss mechanisms to bring more of the ramifications of other business units' decisions into clearer focus, as do the EPs for project finance.[105]

Finally, one of the important features of the EPs is the interaction between the IFC and the 79 banks. While the IFC is the private-sector lending arm of the World Bank, it is an explicitly public-regarding entity with public development objectives.[106] The IFC's Social and Environmental Performance Standards are serious, industry-specific, and evaluated and changed through multi-year, multi-stakeholder collaborations.[107] There are close working relationships between the IFC and the participating banks, especially at the leadership level, including IFC workshops around the world and communications among participants concerning best practices.[108] Through this interactive process at the IFC and among the participating banks, the reach of the IFC's performance standards is being extended, while the range of factors considered important by participants within the participating commercial banks is similarly stretched. Moreover, through constant communication among project bankers and ongoing re-evaluation of the standards, moral challenges are made explicit, difficult trade-offs are negotiated, and discussions of values and norms enabled. This whole process is marked by a striking convergence of motives: fostering peer relations (without, thus far, engendering antitrust concerns), pursuing moral goals, self-interestedly managing risk and reputation, and creating a level, competitive playing field. Perhaps the moral vacuum that social psychologists have seen in so many work environments is thus being addressed.

VI. SUGGESTIONS FOR REFORM

The question to which this analysis gives rise is this: could some of the positive features that we identify in the EPs be used to structure reform efforts in banking more generally, with an explicit mandate to try to affect culture within the TBTF banks? There are three aspects of the EPs initiative that we think worthy of further consideration in this regard: the specifics of its partnership between a public entity and a private industry; the financial mechanisms that cause the EPFIs to internalize any potential negative social and environmental aspects of their lending; and the changes in procedures within the EPFIs to explicitly evaluate social and environmental harm, which together have the effect of

104. *See* Salz, *supra* note 27, at 79–84 (discussing how "leaders devised their own values" and that values play an important role "in shaping a single . . . culture").

105. *See infra* notes 131–156 and accompanying text (explaining that changes in accounting standards, including social accounting through Integrated Reporting, may have significant effects on business-units' decisions, such as "promot[ing] the internalization of social risk").

106. *Our Goals and Values*, INT'L FIN. CORP. (2014), http://www.ifc.org/wps/wcm/connect/corp_ext_content/ifc_external_corporate_site/about+ifc/vision.

107. *See generally Performance Standards on Environmental and Social Sustainability*, INT'L FIN. CORP. (Jan. 1, 2012), http://www.ifc.org/wps/wcm/connect/c8f524004a73daeca09afdf998895a12/IFC_Performance_Standards.pdf?MOD=AJPERES.

108. *See infra* note 110 and sources cited therein.

cordoning off social and environmental responsibility from race-to-the-bottom competition. As we discuss below, it is difficult to develop regulatory solutions that have the power of some of the financial incentives created naturally by the structure of project finance, but there are alternatives that could better moderate the excesses of some units of TBTF banks and widen the scope of banks' concerns.

A. Public–Private Governance Partnerships

The involvement of both public and private actors in standard setting is a hallmark of many new governance regimes, so that is not a unique feature of the EPs.[109] What is worth considering, though, are two aspects of this particular regulatory regime. First, it is a public entity, the IFC, that develops the regulatory standards in the first instance. In contrast, in many new governance regimes, it is private entities, such as industry participants or NGOs, that develop the standards, which governments then rely upon for various reasons, such as in import-export or trade regulations.[110] As a global public entity with a mandate to promote development in order to eliminate poverty (the official mandate of the World Bank), the IFC has developed its Sustainability Framework, with very specific social and environmental performance standards for any investment it makes or loan it extends, using a global process that involves a broad range of stakeholders. The EP III, released in June 2013, are based on the IFC's 2012 iteration of its Sustainability Framework, which was developed in an 18-month, global, multi-stakeholder process conducted in public, with a high degree of transparency.[111]

Public-entity involvement is important for providing greater confidence that the standards being developed are stringent and public-regarding, notwithstanding the

109. *See, e.g.*, Jody Freeman, *The Private Role in Public Governance*, 75 N.Y.U. L. REV. 543, 545–50 (2000) (categorizing types of domestic U.S. public–private governance relationships as privatization–contracting out; delegation of standard setting, either directly or indirectly; self-regulation, either voluntary or mandatory under various U.S. laws; and traditional government standard setting with shared public–private implementation and enforcement); Burkard Eberlein et al., *Transnational Business Governance Interactions: Conceptualization and Framework for Analysis*, REG. & GOVERNANCE 2013, *available at* http://onlinelibrary.wiley.com/doi/10.1111/rego.12030/pdf (developing a framework for analyzing the various ways transnational private regulatory regimes interact with other private regimes and with governments in agenda setting, standard setting, implementation, monitoring, and enforcement).

110. *See generally* Errol Meidinger, *The Administrative Law of Global Private–Public Regulation: The Case of Forestry*, 17 EUR. J. INT'L L. 47 (2006) (discussing various ways the Forest Stewardship Council's privately generated standards have been used by governments); *see also* Lesley Wexler, *Regulating Resource Curses: Institutional Design and Evolution of the Blood Diamond Regime*, 31 CARDOZO L. REV. 1717, 1719 (2009) (discussing the private development of the Kimberley Process for identifying and excluding "conflict diamonds" from international trade, and governments' use of that process to inform export and import restrictions); *see generally* Benjamin Cashore, *Legitimacy and the Privatization of Environmental Governance: How Non-State Market-Driven (NSMD) Governance Systems Gain Rule-Making Authority*, 15 GOVERNANCE 503, 510–11 (2002) (discussing various ways governments use standards developed by new governance processes).

111. *See IFC's Sustainability Framework*, INT'L FIN. CORP., http://www.ifc.org/wps/wcm/connect/Topics_Ext_Content/IFC_External_Corporate_site/IFC+Sustainability/Sustainability+Framework (last visited Feb. 27, 2013) (providing in-depth discussion of the content of the IFC's Sustainability Framework and the procedure used to update the Framework including many of the discussion drafts, summaries of the negotiations, and public meetings that took place over the year-and-a-half that the revisions were underway).

familiar imperfections of public regulatory processes.[112] Indeed, in 2002, when the initiating EPFIs (ING, Citigroup, Barclays, HSBC, and German retail bank WestLB) first started discussing the need for a common framework for managing projects in new environments and emerging economies, their initial view was to reject the IFC Sustainability Framework as being too rigorous.[113] Soon, however, the value of using established, high-quality standards became obvious, as did the difficulties of developing standards from scratch. We infer from this that it is not critical that government per se be the standard-developer, but that the use of a credible, transparent, public-regarding process must be central.

The other noteworthy aspect of this process, which is typical of new governance, is that the regulated industry is voluntarily choosing to be bound by the IFC's standards, unlike traditional "command and control" regulation. That choice is a product of in-depth discussions by bank management of particularized social and environmental risks in particular industries. Both the voluntary nature of the regulatory choice and the moral sensitivity that is encouraged by the EPs discussions are important aspects of the regulatory design that might be emulated more broadly, as discussed below.

Another important example of "co-regulation" in finance is an initiative by the Australian Securities and Investments Commission (ASIC), led by Greg Medcraft, the current chair of the International Organization of Securities Commissioners (IOSCO). In 2011, ASIC was divided into 11 industry sectors. In each sector, employees work with the relevant professional organizations and self-regulatory organizations to develop regulatory standards of best practice.[114] The professions are responsible for developing the standards initially, but they are subject to ASIC's close observation and oversight, and ASIC can ask for revisions where standards are not high enough. Beyond the specifics, Chairman Medcraft has articulated "integrity" as an over-arching goal.[115] At least on paper, such a structure has real potential to allow the cultural power of industry

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112. *See, e.g.*, Julia Black, *Decentring Regulation: Understanding the Role of Regulation and Self Regulation in a "Post-Regulatory" World*, 54 CURRENT LEGAL PROBS. 103, 106 (2001) (discussing a number of challenges regulators face, from lack of in-depth knowledge of current industry trends and risks, to complexity of regulated industries and difficulties in motivating regulated entities to comply fully with legal requirements); Roberta Romano, *The Sarbanes–Oxley Act and the Making of Quack Corporate Governance*, 114 YALE L.J. 1521, 1526–28 (2005) (asserting that Sarbanes–Oxley exemplifies some of the problems of legislation passed in a hurry, before Congressional elections, and without sufficient attention to the empirical and financial literature showing that a number of its provisions were either unnecessary or counter-productive).

113. Symposium, *10 Years Equator Principles: Fragment of a Normative Sustainability Order or Business as Usual?*, GOETHE U. FRANKFURT (Mar. 14–15, 2013) (notes on file with author).

114. For background information on ASIC, see generally Greg Medcraft, Chairman, Australian Sec. & Inv. Comm'n, *Maintaining Market Integrity in a Changing Environment*, Keynote Speech at the Stockbrokers Association of Australia 2012 Annual Conference 2 (June 1, 2012), *available at* http://www.asic.gov.au/asic/pdflib.nsf/LookupByFileName/Maintaining-market-integrity-in-a-changing-environment-pdf/$file/Maintaining-market-integrity-in-a-changing-environment.pdf. For general information on ASIC's market supervision and market integrity rules, see AUSTRALIAN SEC. & INVS. COMM'N, http://www.asic.gov.au (last visited Feb 27, 2014). Through his answers to questions conducted in an interview with one of the authors on September 8, 2011, it became clear that Chairman Medcraft explicitly understands what he is doing as an experiment in co-regulation.

115. *See* Medcraft, *supra* note 114, at 2 (explaining that a need to ensure the maintenance of market integrity is part of ASIC's first strategic outcome); *see generally* Justin O'Brien, *The Future of Financial Regulation: Embedding Integrity Through Design*, 32 SYDNEY L. REV. 63 (2010) (addressing the problem of embedding integrity in capital markets, regulatory practice, and techniques).

self-regulation, with all of its advantages (expertise, autonomy, engagement with the goals of the standards ultimately developed), but with public oversight to ensure that broader public interests are given due regard. This model is one that offers potential for bank regulation to develop in a more cooperative style, while relying on the benefits of self-regulation, as Saule Omarova has suggested in her work on Wall Street as a "community of fate."[116]

One response to this proposal is that regulating finance is already too cooperative; bank lobbyists enjoy privileged access to legislators and regulators and obviously succeed in shaping the law.[117] We agree that this is a concern, either with the regulatory framework now in place, or with this proposed collaborative approach to regulation; though, it is a more serious concern if lobbying is done without the transparency and public oversight that is evident in both the IFC and ASIC processes. Instead of banking organizations such as the Institute of International Finance (IIF), the International Swaps and Derivatives Association (ISDA), or the Financial Services Roundtable (organization of CEOs of 100 largest financial institutions) lobbying against and litigating against rules on leverage, central clearing, capital requirements, and collateral requirements,[118] their proposals would be the starting point for co-regulation, which is how Commissioner Medcraft understands ASIC's new structure. If combined with some of the regulatory design features that Omarova recommends,[119] and with measures to internalize negative externalities, as discussed below, progress could be made in wringing excessive risk out of the financial system and reforming TBTF bank culture.

In evaluating the potential of such a public–private initiative to affect cultures within groups and institutions, social psychology suggests that the relevant criteria should include the following: does the initiative fulfill people's relational needs by encouraging them to work within their industry sub-culture (investment banking, commercial banking, retail banking, securities brokering, investment advising, and insurance) to develop self-regulatory frameworks built upon positive social values? Does the process involve enough ongoing communication to enable serious discussion of competing views of

116. *See generally* Saule T. Omarova, *Wall Street as Community of Fate: Toward Financial Industry Self-Regulation*, 159 U. PA. L. REV. 411 (2011) [hereinafter Omarova, *Self-Regulation*] (proposing that Wall Street be required to develop proposals to wring excessive risk out of the financial system and be held financially responsible if those proposals fail); Saule T. Omarova, *Rethinking the Future of Self-Regulation in the Financial Industry*, 35 BROOK. J. INT'L L. 665, 683–85 (2010) (suggesting that mandatory self-regulation in the financial industry would help to overcome the problems inherent in regulating a complex global industry, where the participants in the industry will always have informational advantages over regulators).

117. *See, e.g.*, Eric Lipton & Ben Protess, *Banks' Lobbyists Help in Drafting Financial Bills*, N.Y. TIMES, May 24, 2013, at A1 (discussing bank lobbyists writing legislation and shaping regulations in an attempt to combat Dodd–Frank).

118. *See, e.g.*, Claire Jones & Patrick Jenkins, *BoE Regulator Moves to Address Concerns over Bank Lobbying*, FIN. TIMES (July 2, 2013, 3:52 PM), http://www.ft.com/cms/s/0/5a676570-e314-11e2-9bb2-00144feabdc0.html#axzz2rv7wEjsG (stating that the Bank of England is considering regulating bank lobbying because it is frustrated by banks lobbying against proposals to require banks to hold 3% equity capital to bank assets (loans) by 2013, which is five years sooner than will be required by Basel III).

119. *See* Omarova, *Self-Regulation*, *supra* note 116, at 483–86 (discussing a system of "embedded self-regulation" in which government would have the power to ban certain financial instruments, empower monitors, and require different self-regulatory regimes and government oversight according to whether the institutions were shifting risk by trading in complex derivatives and structured financial products (Tier I institutions), or not (Tier II, retail, and commercial lending)).

justice, morality, and other people's needs and perspectives? Is the moral muteness characteristic of so many workplaces being addressed? And finally, are people's autonomy interests, and their ability to be self-regulating, being enabled? Hardened executives, long on the self-regarding path, may never be effectively encouraged to care about the public interest, but perhaps cultures could slowly evolve within the TBTF banks (and other financial institutions) so that a wider ambit of concern becomes part of the industry norm.[120] After all, most new recruits into the elite investment banks have been educated in the best liberal arts universities in the world.[121] We assume that many new recruits must have incorporated some of the values of a liberal arts education, and might long for assurance that their work promotes social welfare.

B. Internalizing Negative Externalities

As stated above, one of the most important features of project finance is that the lending is non-recourse, so that payment will only be forthcoming if the project is a success. This has the effect of aligning banks' risk-management interests with the mitigation of social and environmental harm, since those harms could lead to political interventions, labor unrest, protests, violence, or other problems that can slow down or derail a project. In economic terms, the banks are internalizing the potential costs of most potential negative externalities (climate costs being a prominent exception); thus, they are paying attention to minimizing those costs. The salutary effect on management focus is obvious.[122]

The financial crisis has exposed a number of areas of socially risky cultural practices within TBTF financial institutions, as mentioned in Ho's ethnography of Wall Street. These practices include: excessive leverage; excessive M&A deal flow irrespective of long-term consequences for the firms involved (including both target and acquirer); churning of people and securities for firms' short-term benefit, often at the expense of their employees or clients; and creating systemic risk through the invention and trading of complex financial instruments, the risks of which are poorly understood even by their creators.[123] The simplest mechanism to force firms to internalize such social risks would

120. In a recent New York Times opinion piece, the author describes a hedge fund executive's "withering look" and frank disapproval when the author suggested that new hedge fund regulations might be better for the system as a whole. Sam Polk, *For the Love of Money*, N.Y. TIMES, Jan. 18, 2014, http://nytimes.com/2014/01/19/opinion/sunday/for-the-love-of-money.html?_r=o. "I don't have the brain capacity to think about the system as a whole," the executive claimed. "All I'm concerned with is how this affects our company." *Id.*

121. *See* Ho, *supra* note 36, at 62–66 (discussing "feeder schools" such as Harvard, Princeton, Yale, Wharton, Stanford, MIT, Duke, and Columbia, and stating that "the two universities from which prestigious Wall Street investment banks most actively recruit . . . are Harvard and Princeton").

122. *See, e.g.*, Louis Lowenstein, *Financial Transparency and Corporate Governance: You Manage What You Measure*, 96 COLUM. L. REV. 1335, 1335 (1996) (asserting that America's capital markets have been well-served by the requirements of accounting standards that concentrate management focus on financial returns on invested capital, since "you manage what you measure").

123. On excessive leverage, and systemic risk from complex financial instruments and derivatives, see ADMATI & HELLWIG, *supra* note 20, at 129–47. On excessive leverage, see Blair, *supra* note 44, at 225–312; and see generally Wilmarth, *Dodd–Frank*, *supra* note 44, at 955–1057. On churning employees and assets, and on excessive M&A activity and the deleterious effects on target companies and (especially) acquirers, see Ho, *supra* note 36. On deleterious M&A transactions, particularly for large firms and acquirers, see ROBERT F.

be to put a price on these potential harms, either through taxes, fees, or required insurance payments.

Current and proposed capital requirements under Basel II and III are calibrated to the levels of risk of a financial institution's loans and investments. These capital requirements will have the indirect effect of causing banks to internalize the costs of some social risks.[124] In addition, the Federal Deposit Insurance Corporation (FDIC) and unemployment insurance bring about some internalization of social risk as well. Yet, there are a number of ways in which these existing approaches are inadequate. First, the range of problems addressed by conventional financial regulation is narrower than the social and financial risks created by TBTF banks. There are no effective claw-backs when bankers promote M&A deals that create firms that shed employees, outsource work, reduce R&D expenditures, and then underperform in their industry, as do about half of large post-merger firms.[125] Unemployment insurance can only partially address the financial harm of churning employees, and this insurance fails to address the insecurity, humiliation, and guilt that suffuse workplaces where churning is common practice. And while systemic risk is a new object of regulatory inquiry at both the international and domestic levels,[126] it is not yet capable of being adequately addressed with today's regulatory technology and architecture.[127] Moreover, there is no pre-funding in Dodd–Frank of FDIC-like insurance premiums, or taxes, for banks' purported contributions to systemic risk.[128]

BRUNER, DEALS FROM HELL: M&A LESSONS THAT RISE ABOVE THE ASHES (2009). Mergers and acquisitions activities have been slowed down by the recessions in the United States, UK, and Europe, so they may not deserve the adjective "excessive" currently. But M&A activity has been rising since 2013 because firms have been holding huge amounts of cash that is now being re-deployed. *See* Steve Johnson, *U.S. Companies Catch the Early Merger Wave for Best Deals*, FIN. TIMES (Jan. 26, 2014, 5:55 AM), http://www.ft.com/intl/cms/s/0/9315eb42-828a-11e3-8119-00144feab7de.html#axzz2rStnLUF7.

124. *See* BRUMMER, *supra* note 19 (explaining Basel Committee on Banking Supervision's role in forming Basel II and III).

125. *See* BRUNER, *supra* note 123; *see also* Robert Bruner, *Where M&A Pays and Where it Strays: A Survey of the Research*, 16 J. APPLIED CORP. FIN. 4 (2004) (describing a useful summary of Professor Bruner's empirical data and concluding that M&A activity can produce large returns for the selling firm and significant returns for those shareholders, but negative returns or no returns for acquiring shareholders in two-thirds of cases).

126. One creative approach to studying systemic risk uses models of other kinds of complex systems, such as ecological systems, to develop theories about how to create resilience. *See* Robert M. May et al., *Complex Systems: Ecology for Bankers*, 451 NATURE 893–95 (2008) (describing how the Federal Reserve Bank Board of New York engaged scientists in 2006 to start such studies, evaluating bank-to-bank transfers as part of the payment system). The analysis showed that the system is "highly disassortative," with most banks having few connections with each other and a few having thousands—a pattern that creates resiliency in nature. *Id.* at 894. Yet, the authors recognized that nature is not affected by how we think about it, whereas financial systems are affected by fads, herding effects, bubbles, and so forth, and that network theory does not yet have processes by which to incorporate such human influences as psychology and politics. *Id.*

127. *See* John C. Coffee, Jr., *Systemic Risk After Dodd–Frank: Contingent Capital and the Need for Regulatory Strategies Beyond Oversight*, 111 COLUM. L. REV. 795, 795 (2011) (discussing the fact that systemic risk has yet to be adequately understood or addressed).

128. *See* Viral V. Acharya et al., *Taxing Systemic Risk*, *in* HANDBOOK ON SYSTEMIC RISK 226–48 (Jean-Pierre Fouque & Joseph A. Langsam eds., 2013) (suggesting mechanisms to tax contributions to systemic risk); Jeffrey N. Gordon & Christopher Muller, *Confronting Financial Crisis: Dodd–Frank's Dangers and the Case for a Systemic Emergency Insurance Fund*, 28 YALE J. ON REG. 151, 154 (2011) (proposing an FDIC-analogue to address systemic risk, with pre-funding as a central feature).

Second, the mechanisms are flawed even with respect to the potential harms for which a price is being set. A number of commentators have criticized Basel II's and III's reliance on risk-based capital adequacy levels, since these can be easily manipulated through the use of credit default swaps and off-balance-sheet obligations.[129] Basel III also imposes a requirement for total bank equity that is only 3% of total assets, without risk-weighting those assets. Prominent critics such as Admati and Hellwig argue that this equity requirement is too low, giving insufficient attention to the social costs of such thin equity.[130] We submit that Basel III will not constrain the culture of swaggering banks with aggressive risk preferences.

Finally, we are interested in regulatory approaches that could potentially affect bank cultures and sub-cultures. As we have argued above, to be effective, conventional regulatory tools such as the capital adequacy requirements of Basel III depend on the regulated entities wanting to meet the spirit as well as letter of the regulations. In other words, the culture within the TBTF bank must *already* be such that the regulation is thought necessary and important, so that assets are not given disingenuously low risk-weightings, and so that derivatives and off-balance-sheet arrangements are not abused to engage in regulatory sleight-of-hand. From a cultural perspective, the approach of Basel III may actually head in the wrong direction by inviting such behavior.

Looking directly to the non-recourse character of project finance for alternative approaches does not seem fruitful either. Regulators could require M&A deals to be structured like project finance, with lenders getting a much-reduced fee upfront for time and charges, as well as regular payments if and only if the resulting company outperforms the relevant market. But this approach is almost certainly unworkable because the project-resulting company parallel is strained at best and the idea is also politically unrealistic—the entire financial industry would lobby it to death.

C. Changes in Accounting and Disclosure and the Effects on Competition

We must look elsewhere if we are to produce a system that operates as if the bank is being required to internalize potential negative externalities. One promising possibility is to change accounting standards and to require social risk disclosure. Taken together, these reforms might effectively promote the internalization of social risk. More broadly, they might lead to an EPs-like change in risk-assessment procedures within TBTF banks; at a minimum, the social and environmental disclosure requirements would promote consideration of a wider range of risk factors. These changes might in turn provide a context for moral discourse, and, as in some banks participating in the EPs, could possibly change cultures within the relevant business units.

The topic of how to change accounting and corporate disclosure to incorporate a broader range of social and environmental information about a company's actions

129. *See* ADMATI & HELLWIG, *supra* note 20, at 96 (asserting that Basel III "fails to address the basic problem that banks can easily game the regulation," leading once more to very high leverage and extremely risky business practices).

130. Nor is there empirical support for the assumption that increased equity would impose social costs such as reduced lending. *Id.* at 180. *See generally id.* at 176–87 (discussing problems with Basel III, including that the transition period is too long (to January 1, 2019); the required total equity of 3% is "outrageously low"; and required equity to "risk-weighted assets" of 7% allows, and even encourages, banks to use complex models and shift risk through the use of derivatives).

encompasses both theory and developments in practice.[131] The field is variously called sustainability reporting, triple-bottom-line reporting, social audits, corporate social reporting, key performance indicators, sustainability accounting, and multiple capitals reporting. It has developed from a 1960s critique of narrow approaches to accounting, fueled by "anxiety about . . . corporate power . . . and environmental degradation,"[132] to today's metrics, frameworks, and best practices for social reporting that are utilized on a voluntary basis by close to 70% of the Global 250 companies.[133] A brief overview of one particularly prominent initiative will introduce the basic concept and illustrate how engaging in such changed accounting and disclosure might affect cultural practices within different sub-units of TBTF banks.

One preliminary point needs to be emphasized. It might be argued that the problems financial institutions have created are "merely" financial, and so it is off topic to explore social accounting and disclosure. Nothing could be further from the mark. The global financial crisis has had enormous social reverberations, from soaring unemployment rates in the EU, UK, and United States, to tens of thousands of people losing their homes to foreclosures (especially in the United States), to crisis-driven austerity programs throughout Western economies.[134] These austerity programs are draining resources from addressing critical social and environmental problems, such as increasing economic inequality in the United States[135] or addressing climate change,[136] just to name two. The world's economies are still struggling to regain equilibrium, and that fact has long-term social, political, and economic consequences. We emphasize the John Kay epigraph with

131. For a good starting point into this literature, spanning some decades of development, see Rob Gray, *The Social Accounting Project and Accounting Organizations and Society: Privileging Engagement, Imaginings, New Accountings and Pragmatism over Critique?*, 27 ACCT., ORGS. & SOC'Y 687, 687–708 (2002), *available at* http://www.sciencedirect.com/science/article/pii/S0361368200000039 (presenting an overview of definitions and 25 years of development of social accounting); Ans Kolk, *Trajectories of Sustainability Reporting by MNCs*, 45 J. WORLD BUS. 367, 369–70 (2010), (analyzing results of surveys conducted by KPMG, an accounting firm, of sustainability reporting among Global 250 companies in 1999, 2002, and 2005). MNCs are multinational corporations. *Id.* at 367. For one perspective in law, see Cynthia A. Williams, *The Securities and Exchange Commission and Corporate Social Transparency*, 112 HARV. L. REV. 1197, 1293–96 (1999) (evaluating the statutory authority of the SEC to require expanded social and environmental disclosure).

132. Gray, *supra* note 131, at 690. In a fascinating history, Gray shows that some of the earliest, and in his view, most radical restatements about how accounting needed to be "enhanced by social and environmental accounting" were produced by the UK Accounting Standards Steering Committee in 1975, followed closely by the American Institute of Certified Public Accountants (AICPA) in 1977. *Id.* These developments were very much affected by the zeitgeist of 1960s protest movements.

133. *See* Kolk, *supra* note 131, at 369 tbl.2.

134. For an overview, see Lawrence King et al., *Making the Same Mistake Again—Or Is This Time Different?*, 36 CAMBRIDGE J. ECON. 1, 1 (2012) (discussing the economic implications of the financial crisis and the "resort to austerity"). The title is an implicit reference to CARMEN M. REINHART & KENNETH S. ROGOFF, THIS TIME IS DIFFERENT: EIGHT CENTURIES OF FINANCIAL FOLLY (2009).

135. *See* JEFFREY D. SACHS, COMMON WEALTH: ECONOMICS FOR A CROWDED PLANET 258–62 (2008) (discussing economic inequality in the United States, and comparing to that in Canada and in various EU member states).

136. *See* INT'L ENERGY AGENCY, REDRAWING THE ENERGY-CLIMATE MAP: WORLD ENERGY OUTLOOK SPECIAL REPORT (2013), *available at* http://www.worldenergyoutlook.org/media/weowebsite/2013/energyclimatemap/RedrawingEnergyClimateMap.pdf (discussing the need to rapidly expand the use of four proven, but currently expensive, technologies to produce energy to avoid dangerous climate tipping points).

which we began this Article: "The idea that there is something called 'the economy', which is separable from the welfare of society and its citizens, is silly."[137]

Moreover, as we wrote this Article, it was being reported that JPMorgan Chase was settling federal charges of manipulating energy prices in California and the Midwest in 2010 and 2011; in addition, Barclays had been charged by the same federal regulator, the Federal Energy Regulatory Commission (FERC), with manipulating the energy markets in California.[138] JPMorgan Chase is paying $410 million to settle those charges,[139] and Barclays is being sued for $453 million but plans to litigate.[140] Settlements of this type rarely approximate the full social costs of aberrant behavior. Manipulated energy prices can affect businesses, institutions such as hospitals and universities, and individuals, including both residents and those who purchased consumer goods from affected locales. It has also been reported that Citigroup—on the verge of collapse and possibly insolvent in 2008,[141] and kept afloat only by massive federal bail-outs—repaid the taxpayers' generosity by quadrupling the amount of money it transferred to tax havens after 2008, to the tune of $11.5 billion.[142] The essential issue in each of these cases is the critical issue of our time: how can the genius of finance[143] be channeled for positive social development rather than being used solely for private gain at any social cost?

1. An Example of Social Accounting: Integrated Reporting/The International Integrated Reporting Council

To gauge how far sustainability reporting has come, one has only to peruse the website of the International Integrated Reporting Council (IIRC)[144] and note that the chairman of the board is Sir Mervyn King, the immediate past Governor of the Bank of

137. *See* Kay, *supra* note 1.

138. *See U.S. Says JP Morgan Manipulated Market; Settlement Seen*, REUTERS (July 29, 2013 7:47 PM), http://www.reuters.com/article/2013/07/29/us-usa-energy-jpmorgan-idUSBRE96S12K20130729.

139. Scott Disavino, *JPMorgan to Pay $410 Million to Settle Power Market Case*, REUTERS (Jul. 30, 2013, 12:31 PM), www.reuters.com/article/2013/07/30/us-jpmorgan-ferc-idUSBRE96T0NA20130730.

140. David Sheppard, *U.S. Regulator Upholds Record $453 Million Barclays Power-Trade Fine*, REUTERS (July 16, 2013, 7:57 PM), http://www.reuters.com/article/2013/07/16/us-ferc-barclays-powerscheme-idUSBRE96F18G20130716.

141. *See* JOHNSON & KWAK, *supra* note 46, at 172 (discussing stress tests and possibility that Citigroup was insolvent before federal support was forthcoming).

142. *See* Ben Hallman, *Citigroup Avoided Paying $11.5 Billion in Taxes Thanks to Tax Shelters*, HUFFINGTON POST (July 31, 2013, 11:01 AM), http://www.huffingtonpost.com/2013/07/31/citigroup-tax-shelters_n_3672029.html (reporting how Citigroup used tax shelters to avoid U.S. taxation on earnings).

143. *See* ROBERT J. SHILLER, THE NEW FINANCIAL ORDER: RISK IN THE 21ST CENTURY 1–5 (2003) (developing ideas for how new kinds of derivatives, insurance contracts, and securities could be used to democratize finance, promote individual economic security, and encourage economic growth).

144. *See Board*, INTEGRATED REPORTING <IR>, http://www.theiirc.org/the-iirc/structure-of-the-iirc/the-iirc-board/ (last visited Feb. 27, 2014) (listing IIRC board members, with bios). For greater background on Integrated Reporting, see ROBERT G. ECCLES & MICHAEL P. KRZUS, ONE REPORT: INTEGRATED REPORTING FOR A SUSTAINABLE STRATEGY (2010). Robert Eccles is a Professor of Strategy at Harvard Business School, and Michael Krzus is an accountant and former partner at accounting firm Grant, Thornton in Chicago. Together, they have been developing the intellectual case for Integrated Reporting, including its positive effects on firm performance and culture (promoting integrity and an openness to criticism and change), for over a decade.

England.[145] Clearly, we are no longer talking about a pie-in-the-sky project being promoted by 1960s radicals and other worldly academics.

Integrated Reporting (which the IIRC abbreviates as <IR>) is a "concise communication about how an organization's strategy, governance, performance and prospects . . . lead to the creation of value in the short, medium and long term."[146] What is critical to this definition is the concept of "value," which the IIRC website defines as: "accountability and stewardship for the broad base of capitals (financial, manufactured, intellectual, human, social relationship, and natural) and promote understanding of their interdependencies."[147] Aligned with two of the other major, global sustainability disclosure projects, the Global Reporting Initiative (GRI)[148] and the Carbon Disclosure Project (CDP),[149] the IIRC has also recently entered into a Memorandum of Understanding with IASB, the International Accounting Standards Board.[150] This is a private, new-governance initiative that began in London, and its financial reporting standards are now required by over 80 countries' securities regulators, and even permitted for foreign filers by the SEC in the United States.[151] In 2011, 90 companies, accounting firms, and government agencies around the world joined a pilot program to use Integrated Reporting, including Microsoft, Clorox Chemicals, and Coca Cola. Participants evaluated the results of that pilot program, which were issued in a report in the Fall of 2013, and later followed by the first "post-pilot" iteration of the Integrated Reporting framework.[152]

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145. *Governors of the Bank of England*, BANK OF ENGLAND, www.bankofengland.co.uk/about/Documents/pdfs/governors.pdf (last visited March 6, 2014).

146. *About <IR>*, INTEGRATED REPORTING <IR>, http://www.theiirc.org/about (last visited Feb. 27, 2014).

147. *Id.*

148. *What is GRI?*, GLOBAL REPORTING INITIATIVE, https://www.globalreporting.org/information/about-gri/what-is-GRI/Pages/default.aspx (last visited Feb. 27, 2014). The Global Reporting Initiative is the most well-established global initiative that has been developing very specific reporting frameworks for economic, environmental, social, and governance information for close to two decades. Headquartered in Amsterdam, the GRI reporting standards are developed in a multi-stakeholder process that has included accounting firms, companies, units of government, and NGOs. At this point, 600 organizations involved exist worldwide, and the fourth iteration of its reporting framework just launched in May 2013. *About GRI*, GLOBAL REPORTING INITIATIVE, http://www.globalreporting.org/Information/about-gri/Pages/default.aspx (last visited Mar. 2, 2014).

149. *See Catalyzing Business and Government Action*, CDP, https://www.cdp.net/en-us/pages/about-us.aspx ("[CDP] hold[s] the largest collection globally of self reported climate change, water and forest-risk data. Through [CDP's] global system companies, investors and cities are better able to mitigate risk, capitalize on opportunities and make investment decisions that drive action towards a more sustainable world."). In addition, CDP works with thousands of companies, and it represents 767 investors, comprising $92 trillion of institutional capital. *Id.*

150. The International Accounting Standards Board is a private organization based in London that developed the International Financial Reporting Standards (IFRS) in order to provide a global system of accounting that may permit better comparability when evaluating two companies within the same industry that are based in different countries. *About the IFRS Foundation and the IASB*, IFRS, http://www.ifrs.org/the-organisation/pages/IFRS-Foundation-and-the-IASB.aspx (last visited Feb. 27, 2014).

151. Acceptance from Foreign Private Issuers of Financial Statements Prepared in Accordance With International Financial Reporting Standards Without Reconciliation to U.S. GAAP, 73 Fed. Reg. 986 (Jan. 4, 2008) (to be codified at 17 C.F.R. pts. 210, 230, 239, 249), *available at* https://www.sec.gov/rules/final/2008/33-8879fr.pdf.

152. *The International <IR> Framework Released With Business and Investor Support*, INTEGRATED

Initiatives like IIRC's do not abandon financial reporting, but rather add reporting on the social, environmental, and governance aspects of a company's operations. Rather than encouraging the publishing of separate social reports, the initiative is working to develop a single integrated annual report that encompasses financial, social, environmental, and governance information in a concise format that uses quantitative metrics, qualitative discussion, and analysis. The IIRC website emphasizes that the audience for this communication should be the providers of financial capital, but that other stakeholders may find the information useful as well.[153] Proponents also emphasize the financial outperformance of companies that use <IR> or other expanded disclosure frameworks in conjunction with other sustainability policies as measured by both accounting measures and stock market performance.[154] This outperformance may be a product of a number of factors, such as the efficiencies that are found when energy, natural resources, and productive processes are closely examined, and the enhanced satisfaction and productivity of employees when they are part of an open corporation that values their insights and allows critical discourse.[155] It is the latter factor that is of particular interest to us, as it suggests the potential for demonstrable effects on the cultures of companies that engage in this kind of reporting. The vice-chair of NASDAQ (a for-profit company), a recent <IR> reporter, when asked how the company selected the metrics to use for its disclosure, noted that it had more data than it had disclosed, but "in the end, we—like all companies on this journey—have to build an internal culture that embraces that kind of public exposure."[156]

2. Potential Implications for Cultural Reform of Financial Institutions

The power of the EPs to change the culture within project finance and commercial lending units is because of at least two factors: a broader range of risk information being considered when projects are being evaluated and changes within the banks' internal procedures to allow more general discussion of different risks and difficult trade-offs. If banks were regularly participating in the kind of deeper reflection needed to produce an Integrated Report, then that could potentially have a parallel ameliorating effect on the high-risk, high-stakes culture that some of these same banks have exhibited in other aspects of their business. Thoughtfully considering how their current human resources policies were adding value on a short, medium, and long-term basis, for instance, would no doubt produce some angst. The evidence from psychology would suggest that, if many bank employees were engaged in the process of developing the data for an Integrated Report, and reflecting on it, possibly in conjunction with government regulators, then

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REPORTING <IR>, http://www.theiirc.org/2013/12/09/the-international-ir-framework-released-with-business-and-investor-support (last visited Feb. 27, 2014).

153. *Id.*

154. *See* Robert G. Eccles et al., The Impact of Corporate Sustainability on Organizational Processes and Performances 4–7 (July 29, 2013) (Working Paper No. 12-035), *available at* http://www.hbs.edu/faculty/Publication%20Files/12-035_a3c1f5d8-452d-4b48-9a49-812424424cc2.pdf (using a matched set of 180 companies, finding that high sustainability companies significantly outperform low sustainability companies, and that this outperformance persists over a period of 18 years).

155. *See generally id.* (emphasizing natural resources).

156. *See* Ann Goodman, *NASDAQ's Sandy Frucher Takes Stock of Corporate Reporting*, GREENBIZ (Aug. 2, 2013), http://www.greenbiz.com/blog/2013/08/02/nasdaq's-sandy-frucher-takes-stock-corporate-reporting.

there could also be deeper engagement with the concerns of regulators who are trying to produce a more stable financial system and wring systemic risk out of the system. Different business units should be challenged to think about how, in fact, their processes and procedures are creating short, medium, and long-term value with respect to all important types of capital being used.

To summarize, what we suggest is this: using co-regulation, such as that in Australia,[157] bank regulators should adopt the <IR>/IIRC Integrated Reporting framework as the basis for development of key indicators of financial institutions' creation of value. The project can be delegated initially to the banks, working through their professional organizations, but they should be required to use processes of transparency comparable to those of the IFC in developing its performance standards. Different business units within the banks may well determine that different key performance indicators make sense, as such differentiated disclosure is typical of sustainability disclosure. Securities regulators should then require business units to publicly disclose integrated reports and key performance indicators.

VII. Objections and Responses

As we have reflected on the prospects for the kinds of reforms that we propose, we have endeavored to take into account some of the criticisms that they are likely to provoke. The critique we anticipate has three major elements. First, we would expect a general objection to the soft law approach that our proposals embody, with their complementary emphases on self-regulation and the changing of norms. Some might claim that what is needed—at least here, if not always—is new and different hard regulation backed by civil liability and criminal penalties. Our response is that regulation has been tried and found wanting. As we and other colleagues have documented elsewhere, the relative deregulation of American financial institutions over the past generation is not sufficient to account for their sorry performance before, during, and after the 2008 financial crisis.[158] We still have abundant regulation—it just has failed. There is simply no empirical evidence for the proposition that our legislators are smart enough to design—or that our enforcers will have the budget to enforce—new regulations that will *finally* put the cops a step ahead of the financial criminals.[159] Moreover, throughout the history of finance, regulatory capture has followed regulation as the night follows the day.[160]

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157. *See supra* notes 114–116 and accompanying text (explaining Commissioner Medcraft's model for cooperative regulation and how it combines self-regulation and public oversight to ensure integrity in the industry).

158. *See* Saule Omaraova et al., *The United States: With Freedom and Liberty for All*, *in* BANKING SYSTEMS IN THE CRISIS: THE FACES OF LIBERAL CAPITALISM (Suzanne J. Konzelmann & Marc Fovargue-Davies eds., 2012).

159. As we write this Article, there is evidence that regulators themselves are having similar thoughts. *See* Michael R. Crittenden, *Regulators Rethink Complex Rules for Banks*, WALL ST. J., Aug. 1, 2013, http://online.wsj.com/news/articles/SB10001424127887323997004578640314202979922 (reporting that both American and European regulators are considering new approaches to banks' exposure to risk).

160. *See* JOHNSON & KWAK, *supra* note 46, at 93 (discussing ideological or cultural capture of financial regulators by the financial industry); *see generally* Norman S. Poser, *Why the SEC Failed: Regulators Against Regulation*, 3 BROOK. J. CORP. FIN. & COM. L. 289 (2009) (describing history of regulatory capture at the

A related point is that a hard-law response, dependent as it is on the threat of penalties, necessarily depends on a rational-actor model of financial behavior. That is, it assumes that those whose behavior needs to be changed will calculate the costs and benefits of changing and make a rational decision to do the right thing, because it will be in their long-term financial interest to do so. But anthropologists have repeatedly demonstrated that the rational economic actor is as much myth as reality,[161] and psychologists have reached a similar conclusion from a different theoretical angle.[162] As was concluded more than 20 years ago (in an anthropological study of institutional investment), financial decision making often depends less on economic analysis than on "such cultural factors as the quirks of history, the displacement of responsibility, and the nurturing of personal relationships."[163] Culture counts: if it is critical in producing dysfunctional financial behavior, it should have an equally central role in fixing it.

A second critique may be that soft-law responses, especially regulatory ones, may amount to little more than public relations campaigns designed to head off hard regulation.[164] As observers of the soft law corporate social responsibility trend, we have written: "At its worst, it is nothing more than an elaborate public relations charade in which companies perform certain prescribed rituals but continue to do business as usual. . . . [and] the effect of the rituals may be to co-opt critics, mislead consumers, and preempt regulation."[165] But it was also noted that corporate social responsibility was "a work in progress," and that at its best, "it promises a corporate decisionmaking process in which managers think and talk openly about social and environmental issues and then tell the world what they did and why."[166] Both of these observations might also be made about a cultural approach to financial reform: it might prove to be nothing more than a PR charade, but it might also work. Given the demonstrable failure of traditional regulatory approaches, it seems clearly deserving of a try, at the least as an intentionally designed complement to hard law, since the latter is not in any danger of disappearing.

A final critique—rooted, perhaps ironically, in anthropological theory—might focus on the nature of culture. Specifically, culture is not the sort of discrete and simple thing that one can "change" like a light bulb or a tire. Since the mid-twentieth century, anthropology's understanding of culture has shifted from viewing it as robust, relatively bounded, and inherently static to emphasizing the day-to-day practices of cultural actors as they interact and relate to one another.[167] Culture is now seen more as a flexible

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Securities and Exchange Commission).

161. *See, e.g.*, Jean Comaroff & John Comaroff, *Ethnography on an Awkward Scale: Postcolonial Anthropology and the Violence of Abstraction*, 4 ETHNOGRAPHY 147 (2003) (analyzing the "occult economy").

162. *See supra* notes 74–81 and accompanying text.

163. O'BARR & CONLEY, *supra* note 35, at 72.

164. *See* Ford, *supra* note 88, at 483–84 (discussing this concern in the specific context of new governance approaches to financial regulation).

165. John M. Conley & Cynthia A. Williams, *Engage, Embed, and Embellish: Theory Versus Practice in the Corporate Social Responsibility Movement*, 31 J. CORP. L. 1, 38 (2005).

166. *Id.*

167. For a more detailed account of this theoretical shift, see John M. Conley, *Can You Talk Like a Lawyer and Still Think like a Human Being? Mertz's* The Language of Law School, 34 LAW & SOC. INQUIRY 983, 983–87 (2009); Sherry B. Ortner, *Theory in Anthropology Since the Sixties*, 26 COMP. STUD. SOC'Y & HIST. 126 (1984); KAREN SYKES, ARGUING WITH ANTHROPOLOGY: AN INTRODUCTION TO CRITICAL THEORIES OF THE GIFT (2005).

package of shared interpretive resources than as an external force that dominates the individual.[168] Contemporary anthropologists are more inclined to see rules, structures, norms, and other putatively causal forces as "emergent," or continually reproduced by the members of a society in the course of their social lives.[169] A further point is that the relationship between the individual and culture remains—as it has always been—unclear, if not muddled. How does culture, whatever it is, get into the heads of individual people, and how does it exert such influence as it does? The circular "acculturation" continues to be an unsatisfactory answer.[170]

This shift in theoretical perspective has necessitated a rethinking of the nature of cultural change. On the one hand, the contemporary view is that challenge, resistance, and change are normal and constant rather than exceptional.[171] If individuals are not slaves to culture, but are constantly collaborating in its production, variation in every conceivable dimension is to be expected.[172] But the recognition of this constant creative disorder also diminishes the possibilities for "change" as a transitive verb. Instead, change happens, almost always for multiple, complex, and elusive reasons.[173] If cultural norms emerge from the fine-grained details of practice, trying to change them from the top down, even at the directive of powerful institutions, may be an inherently futile endeavor.

The application of this thinking to our proposals raises obvious and serious questions. They boil down to this: does a cultural approach to banking reform depend on a simplistic and outdated idea of culture, and thus of cultural change? In response, we emphasize two points. First, our approach to cultural change is multi-dimensional. We see change as coming from several directions at once—from all levels of affected institutions, abetted by diffusion and borrowing from parallel institutions, both public and private. We believe the EPs case demonstrates this multi-dimensionality. Second, our arguments and conclusions have proceeded at both the group and individual levels, using both cultural and psychological theories and evidence. We have thus attempted to respect culture as real, while at the same time seeing it as an ongoing co-production of individual actors. Once again, the EPs project may provide a modestly encouraging precedent: one aspect of bank culture appears to be changing, with changing individual motives and beliefs standing as both cause and effect.

Notwithstanding the potential limitations on our analysis and proposals, we believe

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168. *See* Clifford D. Shearing & Richard V. Ericson, *Culture as Figurative Action*, 42 BRIT. J. SOC. 481 (1991) (describing that ideas from anthropology propose a conception of culture as a figurative resource).

169. *See* ELIZABETH MERTZ, THE LANGUAGE OF LAW SCHOOL: LEARNING TO "THINK LIKE A LAWYER" 21 (2007) (explaining such forces through the lens of linguistic anthropology); Conley, *supra* note 167, at 984–85 (claiming that "[c]ontemporary anthropologists are more inclined to see structure as 'emergent' in the sense of produced by members of a society as they engage in a particular practice").

170. *See* Ortner, *supra* note 167, at 151 (explaining that the theory that individuals rationally pursue their desires "within the context of their cultural and historical situations" is incomplete).

171. *See generally* JAMES C. SCOTT, DOMINATION AND THE ARTS OF RESISTANCE: HIDDEN TRANSCRIPTS (1990).

172. *See* Comaroff & Comaroff, *supra* note 161, at 166 (stating "an anthropological cliché, albeit an important one: that most of the signs and practices with which we concern ourselves are either contested or, if not, are the object of a polyphony of perceptions, valuations, means and ends").

173. *See id.* at 156 (explaining the challenges of using ethnography to understand the underpinnings of change in the current globalized world).

that two propositions remain self-evident: (1) that the problem of antisocial behavior in TBTF banks is in substantial part cultural, and (2) that, consequently, meaningful reform efforts must have a significant cultural component. Working from the example of the Equator Principles, we have suggested a new governance approach that involves both public and private sectors, and which relies heavily on changes in reporting standards that may engender new practices and processes within financial institutions that may, over time, yield new and better values. Moreover, there is reason to believe that new values, once inculcated in one part of an institution, have the potential to spread—a positive form of social contagion.

The ultimate answer to those who would resist this approach is to pose a question: What else are we to do? Like steroid testing in sports, traditional financial regulation always seems to be one step behind the financial industry. It is time to try something new.