The London School of Economics and Political Science

Regulated organizations: responding to and managing regulatory change

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Declaration

I certify the thesis I have presented for examination for the MPhil/PhD degree of the London School of Economics and Political Science is solely my own work other than where I have clearly indicated that it is the work of others (in which case the extent of any work carried out jointly by me and any other person is clearly identified in it).

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Abstract

This thesis explores how regulated organizations respond to and manage regulatory change. It uses a case study of the significant wave of reforms to financial regulation that followed the financial crisis in 2007-8, reforms which created a moment of great uncertainty and complexity for banking organizations.

Using a combination of discourse analysis on banks' publicly available documents and semi-structured qualitative interviews with 22 members of banking organizations in the UK, this thesis examines how a sample of banks responded to and managed the changes in their regulatory environment.

This thesis found that the uncertainty associated with unclear regulatory rules, unspecified regulatory expectations and shifts in the cognitive underpinnings of financial regulation exacerbated existing tensions between market and regulatory objectives within banks. Managing these tensions required an ongoing process of negotiation and settlement between organizational actors who were 'institutional agents' of market and regulatory logic respectively.

This thesis found that that the balance in the use of these logics changed over time and argues that this is partly due to considerations of legitimacy relative to the external political and economic context, but is also related to the degree of uncertainty and the power and status afforded to the internal representatives of market or regulatory logic. Regulatory interactions between the banks and their supervisors were found to be a critical site where legitimacy criteria are communicated and regulatory professionals construct the bank's regulatory identity.

Finally, this thesis argues that when regulation is in a continual state of flux, possibilities for meaningful behavioural changes are reduced. At the same time, however, continuous regulatory change demanded greater organizational attention, suggesting an acceptance on behalf of the banks that regulatory change had become part of 'business as usual'.

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Chapter 1: Introduction

Large, complex business organizations have become increasingly prevalent and powerful over the last three decades (Carroll, Carson, Fennema, Heemskerk, & Sapinski, 2010; Scott, 1997; Wilks, 2013), generating incredible wealth but also significant risks (Hutter & Power, 2005; Short & Clarke, 1992b). These risks have the potential to cause great societal harm should they come to fruition as was clearly demonstrated by the global financial crisis in 2007-8 (Brian & Patrick, 2010; Foster & Magdoff, 2009; Ötker-Robe & Podpiera, 2013). In this instance, banks and other large financial corporations failed to adequately manage their risks and brought the financial system to the brink of collapse, causing widespread economic damage (Brian & Patrick, 2010; Foster & Magdoff, 2009; Grusky, Western, & Wimer, 2011; Stiglitz, 2010).

Controlling societal risks and preventing harm is at the heart of much contemporary regulatory law (Black, 2010b; Hood, Rothstein, & Baldwin, 2001; Hutter, 2001, 2006a; Rothstein, Huber, & Gaskell, 2006), including that which governs the safety and soundness of the international banking system. The financial crisis called the efficacy of the extant financial regulatory regime into question (Financial Services Authority, 2009e; Financial Stability Board, 2009b, 2009c; Financial Stability Forum, 2008; Larosière, 2009; London School of Economics, 2010) and an extended period of regulatory reform ensued after the immediate shoring up of the financial system had been achieved (Black, 2010a; Ferran, 2012a; Ferran, Moloney, Hill, & Coffee Jr, 2012; Goodhart, 2009; Helleiner, Pagliari, & Zimmermann, 2010; MacNeil, 2010). This created a moment of great uncertainty for those organizations subject to financial regulation – new rules, new regulatory authorities and new cognitive frames were all mobilized by policy-makers against a backdrop of economic decline, increased market volatility and the sovereign debt crisis in Europe (Bank of England, 2010a, 2010b, 2011a, 2011b; Financial Services Authority, 2010b; International Monetary Fund, 2010). This thesis uses this context to explore understandings of how those organizations that were the target of financial regulatory reform responded to those changes and the associated uncertainty. It examines how their public discourses and operational practices were adapted (or not) to the changing regulatory environment and also how these changes affected the relationships between the regulator and the regulated. Examining the mechanics and practices of managing and implementing regulatory change is important because how banks deal with the uncertainties this causes has significant consequences for society as a whole.

Crises, such as the global financial crisis, or other disasters are often the catalyst for regulatory change, because often, a crisis is perceived as a failure of the existing regulatory arrangements (Baldwin, Cave, & Lodge, 2011; Grabosky, 1995; Lodge, 2002) or because the causes of the crisis stemmed from risks that were previously unregulated. Regulatory change is also prompted by the emergence of new risks, associated with scientific innovations, such as nanotechnology (Hodge, Bowman, & Ludlow, 2009) or the development of digital currencies such as bitcoin and their associated technologies (Brito & Castillo, 2013; Tu & Meredith, 2015). Dynamism in regulation was also at the heart of early theories of regulation, such as Bernstein's 'natural life-cycle' view of regulatory agencies (Bernstein, 1955, p. 74). He conceived of these authorities as evolving from 'gestation' to 'old age' in accordance with the level of political and support for the regulatory issue in question. Regulation and associated regulatory regimes are not static, and adapt to changes in technological, societal and political circumstances.

Whilst there is considerable literature on how and why policies (including regulatory policies) change (Baumgartner, Jones, & Mortensen, 2007; Hood, 1994; Keeler, 1984; Sabatier & Weible, 2014), the response of the regulated organizations to these changes remains relatively under-explored (Hutter, 2011b, p. 306). The importance of investigating how business corporations manage regulatory change stems from the role that these organizations play as key producers of risk in society. Corporate organizations are the engine room of wealth creation in neoliberal, market based economies (Hall & Soskice, 2001) but, as Beck notes, 'in advanced modernity the social production of wealth is systematically accompanied by the social production of risk' (Beck, 1992, p. 19). As these new risks emerge, new regulatory strategies and regimes are enacted in attempts to control them (Black, 2010b; Hood et al., 2001; Hutter, 2006a).

The effective management or mitigation of these risks depends to a large extent on how the target organizations respond to the changing regulatory requirements. This becomes even more significant considering the trend in recent years for regulation to move away from traditional 'command and control' regulation towards so-called 'new governance techniques' (Black, 2002a; Coglianese & Lazer, 2003; Ford, 2008; Gilad, 2010; Gunningham & Sinclair, 2009; Hutter, 2011c) which aim to harness an organization's own mechanisms for managing risks. It is worth noting here that this thesis makes a distinction between uncertainty and risk, and follows Power (2007) who contends that the difference between uncertainty and risk does not depend on the level of probabilistic knowledge that is available (Knight, 1921), rather, 'Knightean uncertainties become risks when they enter into management systems for their identification, assessment and mitigation' (Power, 2007, p. 5).

Investigating business responses to regulatory change is also therefore an examination of the relationship between governments and private market actors which has consistently been a central theme in economic sociology (Block, 2010). In this tradition, the state and the market are envisaged as 'mutually constituting spheres of activity' as opposed to 'distinct and opposing modes of organizing economic activity' (Block & Evans, 2005, p. 505). Government and business are not considered as being in direct opposition to each other, rather, they are in a relationship of mutual dependence (Block & Evans, 2005). With respect to regulation, and the regulation of risks in particular, the nature of this mutual dependence can be understood in terms of where responsibilities lie for the control of societal and economic risks. Socio-legal scholars consider regulatory law to be both 'simultaneously constitutive and controlling' (Hutter, 2001, p. 15) and in the context of risk management, the constitutive aspects of regulation 'may aim to penetrate the corporation and to define compliance systems, routines and practices' (Hutter, 2001, p. 16) that are used for managing risks. Starting from this position, this research project explores what happens within organizations not only when those 'constitutive' requirements change, but also when the approach to 'controlling' their implementation also changes.

This introductory chapter provides a brief explanation of the empirical background to this thesis, showing how regulation, risk and the banking industry are interconnected and how they stand in relation to each other. This is followed by a discussion of the sociological and socio-legal literature about regulatory change and regulatory organizations, highlighting the areas that this thesis contributes to. The key research aims and questions are presented, followed by an explanation of the thesis' theoretical orientation.

Regulation, risks and banks

In the world of financial markets and banking specifically, regulation and risk are closely intertwined and interdependent and it is difficult to discuss one without the other. This reflects a broader trend in the regulatory sphere where risk and regulation are being increasingly linked together (Black, 2010b; Hood et al., 2001; Hutter, 2001). Risk can be the object of regulation, a principle around which regulatory agencies organize themselves, a rationalization for regulatory intervention and has a role in evaluating and holding regulators themselves to account (Black, 2010b). Regulation has not always been articulated in terms of risk. Indeed, early regulatory theorists viewed regulation as a purely economic intervention to correct market failures, so called 'command and control' regulation. More recently, the growth of sociological interest in regulation has resulted in a view of regulation as a form of social control, 'an organized response to problems, to deviance, and in particular to risk in economic life' (Hutter, 2001, p. 12) involving both state and non-state actors (Black, 2002a; Hutter, 2006b, 2011c). This thesis follows this concept of regulation as the regulation of risk, and focuses mainly on state-based sources of control, acknowledging that this does not necessarily always take the form of command and control regulation.

Regulation targets the risks of economic life that are the inadvertent, manufactured risks resulting from technological and scientific expansion and the increasing complexity and globalization of contemporary life (Beck, 1992, 2006; Giddens, 1999). The task of regulating these risks is not an easy one, as risk as both a concept and an object is slippery and unstable. Conceptions of risk vary according to academic disciplines, from the rational and objective view of risk as something that can be measured and analyzed, to social psychological research on the variability of psychological perspectives on risk through to the sociological understandings of risk found in the risk society thesis (Lupton, 1999b; Renn, 1992; Zinn, 2008). As object, decisions have to be taken as to which risks require regulation, how they should be assessed and whether regulation should be aimed at risk prevention and/or increasing resilience (Black, 2010b).

These problems surrounding the control or management of risks are not unique to regulators. Banks have had to consider these issues since their early days of simple money-lending. To some degree, the question of which risks need to be managed was more straightforward given that their borrowers might default on loans (credit risk), that their depositors might request their funds to be returned simultaneously (liquidity risk) or the that there may be adverse movements in interest or exchange rates (market risk). More pertinent, perhaps, is the question of how these risks should be measured. The last forty years have seen exponential increases in the sophistication of risk measurement models and techniques for risk analysis in the financial industry (Buehler, Freemen, & Hulme, 2008; Guill, 2016) sparked by the development of the Black-Scholes-Merton model for pricing financial instruments (MacKenzie, 2006). Driven by the increasing sophistication of financial products and the parallel availability of ever greater computing power, these risk management models spread and became part of core banking operations. The late 1980s and early 1990s saw the emergence of the use of other risk management techniques, such as the use of Value-At-Risk[1] for measuring and managing market risk (Buehler et al., 2008; Guill, 2016).

The 1980s also witnessed the increasing globalization of the banking industry with differences in national capital regulations affording banks from some countries, such as Japan, competitive advantage over others in the UK and US. At the same time, there was growing concern about the stability of the global financial system due to low levels of

[1] Value-At-Risk or VaR is a statistical technique which measures the worst expected loss over a given time interval under normal market conditions and at a particular confidence level, the latter being a measure of the reliability of a result.

capital[2] held by internationally active banks (Tarullo, 2008, pp. 44-49). These two issues resulted in calls for international regulations on capital ratios[3] and under the auspices of the Basel Committee on Banking Supervision[4] (BCBS), the first global capital accord, known as Basel 1, was brought into force in 1988 (BCBS, 1988). This required banks to perform a simple calculation, based on the riskiness of the credit assets they held, to determine a minimum amount of capital they should hold in order to absorb losses in the event of a crisis or default.

The increasing risks posed by the rise in derivatives[5] trading and the volatility of the foreign exchange markets prompted an amendment to Basel 1 in 1996 to include market risks (Goodhart, 2011; Tarullo, 2008; Wood, 2005). The large banks pushed for the regulation to align with the risk management techniques that they had already been using (Holton, 2002) for the calculation of market risk, namely Value-At-Risk (Goodhart, 2011, p. 250; Tarullo, 2008, p. 63). They were successful as the Market Risk Amendment (BCBS, 1996) permitted banks to calculate their capital requirements for market risk based on VaR. This set a precedent for prudential regulation to assimilate the risk analysis technologies that banks were already employing, and further revisions to the Basel Accords (known as Basel 2), in force in the UK from 2007 onwards, included more sophisticated methods for the calculation of credit risk, allowing banks to use their own risk models to determine the riskiness of their assets.

Basel 2 (BCBS, 2004), however, was not just about more advanced risk measurement. It was about improving risk management practices within the financial markets and ensuring that senior management of financial organizations are responsible for the

[2] Capital is primarily composed of shareholders' equity in the bank and in the event of default, will act in a loss absorbing capacity

[3] A capital ratio measures the amount of shareholder equity relative to the banks total assets (see Chapter 3).

[4] The Basel Committee on Banking Supervision is an international standard setting body which focusses on the prudential regulation of the global banking industry with the objective of enhancing the stability of the global financial system. At the time the research for this thesis was conducted, the members comprised senior officials responsible for banking supervision or financial stability issues in central banks and regulatory authorities from the following countries: Argentina, Australia, Belgium, Brazil, Canada, China, France, Germany, Hong Kong SAR, India, Indonesia, Italy, Japan, Korea, Luxembourg, Mexico, the Netherlands, Russia, Saudi Arabia, Singapore, South Africa, Spain, Sweden, Switzerland, Turkey, the United Kingdom and the United States. The Chairman of the Committee at this time was Mr Stefan Ingves, Governor of Sveriges Riksbank.

[5] A derivative is a financial instrument whose value is dependent on an underlying market variable such as an equity price, an interest rate or a foreign exchange rate

effectiveness of their risk management and internal control processes. The Basel Committee on Banking Supervision states that

> *'It is not the Committee's intention to dictate the form or operational detail of bank's risk management policies and practices. Each supervisor will develop a set of review procedures for ensuring that banks' systems and controls are adequate to serve as the basis for capital calculations' (BCBS, 2004, p. 2).*

Basel 2 then, was an example of management based regulation, a type of 'new governance technique' where 'regulators do not prescribe how regulatees should comply, but require them to develop their own systems for compliance and to demonstrate that type of compliance to the regulator' (Black, 2012a, p. 1045). Power considers that Basel 2 went even further and 'as a regulatory project of control may be without precedent in its attempt to reach into the micro-managerial world of banks' (Power, 2007, p. 109).

The standards themselves contained a mixture of high level principles and very prescriptive rules, detailing the precise formulae that banks had to use to calculate their minimum capital requirements. One of the high level principles of the Basel requirements which demonstrates the pervasive intent of Basel 2 was known as the Use Test (BCBS, 2006a). This requires that if a bank is using its own internal risk models for the calculation of regulatory capital requirements, the outputs of these models also had to be used in the day-to-day risk management activities of the firm such as strategy and planning, the reporting of risk information and the ongoing monitoring and control of credit risk exposures. Prudential regulation, therefore, with the move from Basel 1 to Basel 2 and the inclusion of sophisticated risk modelling techniques in regulation, had morphed into the regulation of risk management itself – 'the risk management of risk management' (Braithwaite, 2003, p. 7). Following the financial crisis, significant amendments and additions have been made to the BCBS prudential standards (see Chapter 3). It is these changes and more importantly, banks' responses to them that comprise the empirical setting for this research.

Academic perspectives on regulatory change and regulated organizations

Regulatory Change

For the purposes of this thesis 'regulatory change' has been understood broadly to encapsulate small scale changes to particular regulatory rules to wholesale shifts in how the government exerts control over social and economic life (Hood, 1994; Moran, 2003). Academic approaches to regulatory change tend to highlight the key questions of what prompts or provokes regulatory change[6] and how that change manifests itself in regulatory reform.

As mentioned above, triggers for regulatory change can be endogenous or exogenous to the regulatory system. In the case of the former, private interest theories of regulation suggest that the 'capture' of the regulatory regime creates conditions which prompt regulatory reform (Bernstein, 1955; Keeler, 1984; Peltzman, 1976; Stigler, 1971). Capture of a regulatory agency is said to occur when that agency no longer operates in the public interest, rather, it aligns with the interests of the regulated community. Different mechanisms of capture are suggested by the various capture theorists – from the life-cycle approach of Bernstein (Bernstein, 1955), to the 'original sin' version proposed by Stigler (Stigler, 1971) whereby the regulator was corrupted by the regulated industry from the start. More recently, additional non-materialist mechanisms such as 'cultural' or 'cognitive' capture have been developed (Kwak, 2013) particularly in relation to the events of the financial crisis. For the purposes of this thesis, the specific mechanism of capture is of secondary importance. The key point is that capture is regarded as a failure of regulation (Lodge, 2002) and is therefore a trigger for regulatory reform. Other endogenous factors which might trigger change have also been identified by the 'institutionalist' school of regulatory theories. These include problems with the design of the institutional structure of the regulatory system itself or side-effects associated with the overlapping of various parts of the regulatory system (Baldwin et al., 2011, p.

[6] There is also a vast literature within political science which studies the public policy process. This includes several theories that attempt to account for policy changes over time, acknowledging that the policy process is complex and dynamic involving many actors with different preferences and interests, situated within specific socio-economic contexts (Weible, 2014). The specifics of these theories are not directly relevant to this thesis which focuses on the effects of these policy changes on the target population.

76). Additionally, cultural theory suggests that unintended consequences and paradoxical outcomes are inherent in the pursuit of any one particular regulatory strategy (Baldwin et al., 2011; Grabosky, 1995; Hood & Peters, 2004) and that regulatory change is required to address these.

Exogenous factors such as the creation (or construction) of new risks associated with scientific and technological advancements can also prompt regulatory change – either by extending existing regulatory regimes or creating new regulatory structures. For example, the creation of virtual currencies such as bitcoin and its associated risks (such as use for criminal activity, money laundering and terrorism financing) has prompted discussion amongst policy-makers as how best to mitigate these risks, either within the existing legal framework or by the creation of new laws (Brito & Castillo, 2013; Chuen, 2015; Kaplanov, 2012; Tu & Meredith, 2015). Secondly, crises or disasters can elicit significant regulatory reform (Boin, McConnell, & Hart, 2008; Hutter & Lloyd-Bostock, Forthcoming), demonstrated clearly by the 2008-9 financial crisis (Ferran, 2012a; Ferran et al., 2012; Goodhart, 2009). There are many other examples of regulatory change following a crisis such as the introduction of the Sarbanes-Oxley legislation following the Enron fraud in 2002, the creation of the UK Food Standards Agency in the UK following a series of food crises in the 1980s and 1990s (Hutter, 2011a) and the introduction of the Fire Precautions (Sub-surface Railway Stations) Regulations 1989[7] in response to the fire at King's Cross Underground station.

Finally, examinations of large scale policy and regulatory reforms, such as the move from Keynesian macro-economic policies to the monetarist school have pointed to the 'power of ideas' to explain regulatory change (Hood, 1994). This explanation suggests that policy changes arise out of a shift in the prevalent ideological or intellectual climate, drawing on 'theoretical breakthroughs' in the realm of economics or other academic disciplines (Hood, 1994, pp. 6-7).

[7] Available from http://www.legislation.gov.uk/uksi/1989/1401/contents/made

In thinking about the types of regulatory change that may occur, Black draws on Hall's typology of the three orders of policy change (Hall, 1993) and applies it in the regulatory context (Black, 2005, pp. 9-11). According to Hall, first-order changes occur when the settings of policy instruments are 'changed in the light of experience and new knowledge, while the overall goals and instruments of the policy remain the same' (Hall, 1993). Black equates these changes to the 'sharpening of the scythe' which, though seemingly minor, may actually have a large impact on the target population (Black, 2005, p. 9). In the world of prudential regulation, first-order changes would consist of changes to the prescribed calibration of the formulae used to calculate regulatory capital requirements. Second-order changes involve modifications to regulatory techniques or processes and can include the re-organization of regulatory authorities, changes to legal rules or even a shift from legal rules to other regulatory instruments (Black, 2005, p. 10). The move from the first Basel Accord to the second is an example of second order change. Finally, third-order changes are labelled 'paradigm shifts' (Hall, 1993, p. 279), where a paradigm is a kind of 'interpretive framework' through which the policy-makers view the world. The 'power of ideas' explanation for regulatory change discussed above attempts to account for how such shifts in the interpretive frameworks of a regulatory regime may come about. Such a shift occurred in the aftermath of the financial crisis when policymakers began to focus on the overall risks of the financial system (systemic risk) and began the process of developing macroprudential[8] policy (Baker, 2013; Moloney, 2012). The scale of regulatory change can therefore vary, but as Black notes, 'the cumulative effect of several first-order changes may over time have radical or transformative effects' (Black, 2005, p. 9) and so it is important to note that what may seem to be small adjustments to regulatory instruments may still have a large impact on the regulated population.

[8] Macroprudential policies are those aimed at the stability of the financial system in its entirety, aimed at mitigating systemic risk. They include (but are not limited to) countercyclical capital buffers, limits to leverage (the ratio of assets to liabilities) for a financial institution and system-wide stress testing. For a full review see Freixas, Laeven, and Peydró (2015)

Regulated organizations

In the early regulatory literature, commensurate with the dominant views of organizations in the 1970s and early 1980s, regulated firms were conceived of as self-interested, rational actors with the goal of utility maximization (Peltzman, 1976; Stigler, 1971). Organizations were treated as undifferentiated wholes, with very little attention paid either to their 'inner life' or to their relationship with their external environments. Regulation was considered, therefore, to be the natural opponent to organizations, an intervention to constrain the market, and deterrence as the most effective method of regulatory enforcement (Hutter, 2001, p. 13). Challenging this neo-classical view of organizations were the emerging models of organization theory, where organizations were understood to have multiple goals, internal diversity of interests and cultures, and interdependent relationships with their environment (Scott, 2003). This also prompted a reimagining of regulation and an increasing academic interest in regulation from the perspective of the regulated.

By far the most frequent theme for this body of research has been that of compliance, where the notion of compliance itself is problematized and explored. Compliance is fundamental to the understanding of regulation as it is the key mechanism through which regulatory objectives are achieved and risks are controlled. Two distinct but related sets of literature investigate compliance from the perspective of the regulated. First, compliance is often used as a lens to assess the effectiveness of regulation (Amodu, 2008). By understanding the factors that determine compliance (or non-compliance), better regulation with flexible enforcement strategies can be designed to obtain greater levels of compliance from regulated firms (Ayres & Braithwaite, 1992; Baldwin & Black, 2008; Black & Baldwin, 2010). Second, compliance is envisaged as an ongoing process of negotiation rather than a one off event (Hutter, 1997). This allows for the examination of how the meanings of compliance are constructed in the social interactions between the regulated and the regulators, how understandings of compliance may vary within a regulated organization and how an organization's external environment can have a bearing on its compliance behavior.

The empirical studies that consider compliance as the key to understanding the effectiveness of regulation have examined several aspects; exploring the motivations of firms to comply, (Gunningham, Kagan, & Thornton, 2004; Winter & May, 2001) identifying the characteristics of firms which impact compliance (Corneliussen, 2005; Gray & Shadbegian, 2005; Howard-Grenville, Nash, & Coglianese, 2008) and creating typologies of attitudes or 'motivational postures' of regulated organizations towards regulatory compliance (Braithwaite, 1995; Braithwaite, Braithwaite, Gibson, & Makkai, 1994; Kagan & Scholz, 1984). This substantial body of work covers a range of industries such as care homes, paper and pulp mills, agriculture, manufacturing and even individual tax payers and there is a strong focus on environmental and health and safety regulation, and on inspection-based regulatory regimes. The findings from these studies have made a significant contribution to understanding the factors that can influence compliance behavior, with the corollary being how that knowledge can then shape better regulation and enforcement strategies (Ayres & Braithwaite, 1992).

In viewing compliance as a process, the ways in which varying meanings of compliance are constructed throughout a regulated organization can be investigated. This research tends to focus on individuals within the organization, and has discovered that there are 'significant differences among compliance efforts by differentially located individuals within firms' (Gray & Silbey, 2011, p. 127). Indeed, empirical research into safety regulations in laboratories has uncovered variations in conceptions of regulation depending on the autonomy of the organizational actor, their technical expertise and how much they know about the regulators (Huising & Silbey, 2011; Silbey, 2009). This variation in understandings of regulation (and risk) was also a finding in Hutter's studies of environmental health and safety inspectors, and risk and regulation on the British Railways (Hutter, 1997, 2001).

The processual view of compliance also points to the repeated regulator-regulatee encounters, through which compliance is constantly negotiated and renegotiated (Hutter, 1997, pp. 13-14). In her model of legal endogeneity, which draws on neo-institutionalist theory, Edelman and her colleagues regard organizational compliance as ‘a processual model in which organizations construct the meaning of both compliance and the law’ (Edelman & Talesh, 2011, p. 103). Gilad takes this model further to suggest that ‘meanings of regulation and compliance are shaped by regulators’ and business professionals’ interactive and iterative framing of regulatory problems and solutions’ (Gilad, 2014), again emphasizing the importance of the space where the regulated and the regulators meet. Finally, Hutter and Jones (2007) have shown there are other, external influences on an organization’s compliance behavior with regards to regulation. As might be expected, the regulators themselves exert a considerable amount of influence, but organizations are also mindful of other actors, including the media and trade associations, which can help to shape the motives and preferences of business and thus affect their internal workings.

This large body of regulatory research uses compliance as a lens to explore the wider regulated organization. There is an opportunity for further investigation from the perspective of how regulated organizations manage other aspects of regulation, especially regulatory change. This might include how firms make sense of the changes and their impact on the organization, decision-making about how best to implement regulatory changes and how to manage regulatory changes in terms of interactions with the regulator. This study then, builds on the literature about regulated organizations and acknowledges two specific suggestions for further work. Hutter (Hutter, 2011b) calls for greater knowledge about how ‘businesses respond to this changing regulatory environment’, and Gray and Silbey propose that more research into the ‘habitual quotidian enactment’ (Gray & Silbey, 2011, p. 123) of regulation would help to understand the ‘other side’ of the compliance relationship.

Research aims and research questions

The key objective of this research project was to explore how regulated organizations responded to regulatory change. It uses the case study of the prudential regulation of the banking industry, which is designed to be constitutive of the risk management activities of banking organizations to maintain financial stability (Hutter, 2001; Shearing, 1993). This case has been selected because prudential regulation is the regulation of risk management, risks which have the potential to cause significant societal and economic harm. In addition, the degree of regulatory change exhibited after the financial crisis is significant, and consisted not only of changes to regulatory rules but also to styles of supervision and more fundamentally, the underlying philosophies and cognitive frames of the regulators.

As Ford (2013) has noted, much of the literature on regulated organizations, particularly that which asks questions about regulatory effectiveness, has taken place in

> *'a context where an inspector is engaged in a direct relationship with an inspected party, in relation to a bounded physical space, around a relatively straightforward set of regulatory compliance criteria' (Ford, 2013, pp. 17-18)*

The prudential regulatory context differs significantly to Ford's description in three key aspects. The prudential 'regulatory space' (Hancher & Moran, 1989) comprises a multiplicity of regulators with the division of regulatory tasks between several bodies across many jurisdictions. Policymaking occurs at international, regional and national levels (see Chapter 3) whereas the supervision and enforcement of the prudential standards is usually the responsibility of the national regulatory authorities[9]. Prudential regulation also relies more on anticipatory, monitoring activities than *ex-post* enforcement[10] (Moloney, 2012, p. 120). The set of criteria by which compliance is judged by bank supervisors are also somewhat opaque. As an example of management-based regulation, the prudential standards put the onus on banks to make their own decisions about what constitutes compliance because not all the criteria against which supervisors judge compliance are written into the regulatory rules.

The intention is that the uncertainties and additional complexities of this regulatory setting will enable the study to add to existing understandings of regulated organizations, and the regulatory process more broadly in three key ways. First, to address the gaps in the regulatory literature highlighted by Hutter and Gray & Silbey,

[9] The exception to this is the European Single Supervisory Mechanism, whereby the European Central Bank is responsible for the prudential supervision approximately 150 banks within the eurozone (Ferran & Babis, 2013; Moloney, 2014).

[10] It should be noted that regulatory approvals related to the compliance of risk models are required before they can be used for regulatory purposes.

the study investigates the symbolic and material practices that banks use to manage change in the prudential regulatory environment, and how they transform the uncertainty of regulatory change into a risk to be managed. Second, by viewing regulation as both the regulation of risk and an object of risk management, the aim is to develop the risk regulation literature further by focusing on the internal management of regulation and determining the manner and extent to which regulation is 'constitutive and controlling' of a particular set of organizations. The final research objective is to extend the existing compliance literature by exploring the dynamics of the regulator/regulatee relationship from the perspective of the regulated organization to better understand the nature of compliance.

Based on these research aims and in relation to the empirical setting, the central research question is:

How do banks in the UK respond to uncertainty and changes in the prudential regulatory environment?

As Chapter 3 explains, the post-crisis regulatory environment in the UK was in a state of flux at the time this research was conducted between 2013-14. There were new rules coming into force, and new regulatory bodies had been created declaring significant changes in their approach to banking supervision, all of which directly affected banks in the UK. Several of these banks were the sites for the empirical fieldwork which was conducted between 2013 and 2014. They were (and still are) regulated by the UK's Prudential Regulatory Authority (PRA), a new regulatory body set up after the financial crisis, following the break-up of the then extant Financial Services Authority (FSA)[11]. More broadly, regulatory change had taken an increasingly prominent place in banks' public discourses since the financial crisis, and the research also explores this over the period 2006-13 to investigate the nature of this discourse and how and why it changed in relation to the regulatory environment.

[11] The Financial Services Authority (FSA) was disbanded in 2012 and three new regulatory bodies were created, the Financial Conduct Authority (to focus on customer protection, market abuse and conduct of business regulation), the Financial Policy Committee (which has a mandate to monitor systemic financial risk) and the Prudential Regulatory Authority (PRA) both of which are part of the Bank of England (see Chapter 3).

The central research question broken down into three sub-questions, each one relating specifically to the three research aims outlined above:

How do banks respond to and manage changes in the prudential regulatory environment?

How do changes in the prudential regulatory environment affect UK banks' interactions with the national prudential regulator?

To what degree do changes in the prudential regulatory environment become institutionalized within UK banks?

Theoretical orientation

This research project draws on three distinct sets of sociological theory to explore the research questions articulated above. First, neo-institutional organizational theory provides a framework for understanding how organizations might be affected by and respond to changes in their external environments. Second, sociological literature on organizations, uncertainty and risk is used to explore how organizations might deal with the uncertainty associated with external change, and regulatory reform in particular. Finally, socio-legal literature about corporate responses to regulation and regulatory enforcement and compliance is used to frame the inquiry into the possibilities for the institutionalization of prudential regulation and the nature of the post-crisis regulatory interactions.

Organizations and changing environments

It is widely acknowledged in organizational theory that organizations are embedded in wider environments consisting of specific social, physical, technological and political contexts (Granovetter, 1985; Scott, 2003, 2007; Tsoukas & Knudsen, 2005). Organizational institutionalism is of particularl relevance because it conceives of organizational environments as containing institutional forces that both empower and constrain the actors within it. Institutions themselves are the 'taken-for-granted' frameworks for patterning social behavior, consisting of normative beliefs, cognitive understandings and material practices which infuse social life with meaning (Friedland & Alford, 1991; Greenwood, Oliver, Suddaby, & Sahlin-Andersson, 2008; Scott, 2007). The environments of contemporary organizations are characterized by institutional plurality (Kraatz & Block, 2008), where competing and conflicting demands stem from a variety of institutional sources such as the state, the market, family or religion (Friedland & Alford, 1991). These conflicting pressures are 'constitutional and ideational; suffusing the organization rather than impinging upon it' (Kraatz & Block, 2008, p. 244). This thesis makes use of the institutionalist perspective on organizations in two main ways. Firstly, the idea of 'institutional logics' provides a heuristic framework to help to understand the organizational environment of the UK banks as subjects of this research. Second, the institutional approach theorizes a repertoire of possible strategic responses that organizations may employ to make adaptations to their changing environments.

The institutional logics approach argues that organizations need to be examined in the context of the wider society in a way that can show how interests are institutionally influenced. Accordingly, society is viewed as an 'inter-institutional system' comprising of a number of institutional orders (such as the state, religion, the market) each of which has its own logic. These logics are defined as 'a set of material practices and symbolic constructions which constitutes its organizing principles and which is available to organizations and individuals to elaborate' (Friedland & Alford, 1991 p248). The symbolic aspects of institutions are made concrete via social relationships and 'institutional transformations are therefore associated with the creation of both new social relationships and new symbolic orders' (Friedland & Alford, 1991 p250). This means that not only do the institutional logics shape the behavior of social actors but they provide those actors with practices and symbols which can be manipulated, reinterpreted or used to serve their own purposes[12].

What is meant by 'symbolic constructions' and 'material practices' and how are they connected together? Thornton et al. (2012) explain:

> *'By material aspects of institutions, we refer to structures and practices; by symbolic aspects we refer to ideation and meaning, recognizing that the symbolic and the material are intertwined and constitutive of one another' (Thornton et al., 2012, p. 10)*

[12] This is not to say that institutional logics are deterministic. Indeed, Thornton, Ocasio, and Lounsbury (2012) hold that logics have both enabling and constraining effects on social action and they provide a model to account for the role of agency in organizational and institutional change. According to this model, institutional logics provide the cognitive and social building blocks for how social actors 'transform and reproduce social and cultural structures' (Thornton et al., 2012, p. 98) through their social interactions. This then allows for variation in the degree to which social actors are embedded in and are committed to particular institutional logics within the same organization.

Symbols are represented in the theories, narratives and frames contained in discourse or texts such as the public documents produced by banks e.g. annual reports and regulatory consultation responses (see Chapter 2). Theories are internally coherent, abstract forms of symbolic representation and contribute to the consistency of institutional logics. Frames act as interpretive schemas, and are ways of viewing and conferring meaning to the world. Narratives attribute meaning to a series of specific events or actions and according to Thornton et al. (2012), link frames and theories to the material practices of institutional logics. The focus on the symbolic lends itself to an interpretive style of analysis, focusing on the discursive mechanisms that organizations might employ, such as creating narratives or story telling (Lounsbury & Glynn, 2001), using rhetoric (Suddaby & Greenwood, 2005) and creating texts (Phillips, Lawrence, & Hardy, 2004).

Following the so-called ‘practice turn’ in social sciences (Ortner, 1984; Reckwitz, 2002; Schatzki, Knorr-Cetina, & von Savigny, 2001), Thornton et al conceive of practices as ‘constellations of socially meaningful activity that are relatively coherent and established’ (Thornton et al., 2012, p. 128). In this research context, examples of material practices might be the IT systems and processes that banks use to measure, monitor and manage risks.

Thornton et al. (2012) build on Friedland and Alford (1991) by creating ‘ideal type’ institutions for the key societal institutional orders of state, market, community, family, religion, profession and corporation. For each of these institutional orders or systems, these authors provide examples of their categories or organizing principles.

Several scholars have used the institutional logics perspective as the basis for empirical inquiry to research topics such as the effects of logics as they change over time (Lounsbury, 2002; Thornton & Ocasio, 1999), the plurality and complexity of the institutional environment (Battilana & Dorado, 2010; Boxenbaum, 2006; Greenwood, Díaz, Li, & Lorente, 2010; Kraatz & Block, 2008), how logics can affect the behavior of groups and organizations (Alvarez, Mazza, Pedersen, & Svejenova, 2005), and the interactions between organizational (or individual) identity and institutional logics

(Glynn & Lounsbury, 2005; Pache & Santos, 2010; Reay & Hinings, 2005, 2009; Smets, Morris, & Greenwood, 2012). These studies cover an array of research contexts from healthcare (Currie & Spyridonidis, 2015; Reay & Hinings, 2005, 2009) to design (Durand, Szostak, Jourdan, & Thornton, 2013) to finance (Battilana & Dorado, 2010; Lounsbury, 2007).

Four key insights that result from this significant body of scholarship are particularly useful for this study. Firstly, several studies have demonstrated that organizational fields do not always exhibit one dominant logic (Dunn & Jones, 2010; Greenwood et al., 2010; Marquis & Lounsbury, 2007; Reay & Hinings, 2009). Indeed, 'often there is no decisive shift from one logic to another, but an ongoing interaction between two or more logics' (Berman, 2012, p. 263).

Secondly and following on from the first point, the existence of several logics in a pluralistic institutional environment does not necessarily result in conflict or competition between them. Indeed, as Currie and Spyridonidis (2015) suggest, the relationship between multiple logics may be 'co-operative, orthogonal or blurred' (Currie & Spyridonidis, 2015, p. 78).

Thirdly, standing in opposition to several other studies (Battilana & Dorado, 2010; Lounsbury, 2007; Seo & Creed, 2002), McPherson and Sauder (2013) importantly challenge the assumption that 'each logic is tied to distinct subgroups, and it is the balkanization of commitments to different logics that creates dynamic tensions within these fields' (McPherson & Sauder, 2013, p. 167). As their research into the ground level enacting of logics in the day-to-day workings of a drug court in the United States shows, the picture is more complex:

> *'logics serve as tools that can be used by actors in a contested environment to influence decisions, justify activities or advocate for change. The same logic, for example, could be used in different situations to achieve opposite goals, and the same actor may choose to employ different logics at different times depending on the perceived needs of the immediate situation' (McPherson & Sauder, 2013, p. 167)*

This suggests that the meanings of the symbols and practices of institutional logics are not stable, and can be used strategically by organizational actors, echoing the clams made by Friedland and Alford (1991) and Thornton et al. (2012) discussed above.

Finally, given that institutional logics themselves can be dynamic, they must be considered as contingent on the particular historical and geographical context of the empirical setting (Greenwood et al., 2010). Therefore, it is not possible to fully understand how an organization may respond to the plurality of its institutional environment without also considering the prevailing political, economic and social context.

Organizational institutionalism is also instructive regarding the types of strategies that organizations may mobilize in response to changes in their environment. Oliver (1991) developed a typology of responses to institutional pressures, drawing on resource-dependence[13] and institutional analysis of organizations. She identified five broad strategies of response, presented here in Table 1.1 in order of increasing agency on behalf of the organizational actors. These are acquiescence, compromise, avoidance, defiance and manipulation. Within each of these categories, three types of tactics are available, also shown in Table 1.1.

Table 1.1 Strategic responses to institutional pressures

Strategies	Tactics	Examples
Acquiesce	Habit	Follow invisible, taken-for-granted norms
	Imitate	Mimicking institutional models
	Comply	Obeying rules and accepting norms
Compromise	Balance	Balancing the expectations of multiple constituents
	Pacify	Placating and accommodating institutional elements
	Bargain	Negotiating with institutional stakeholders
Avoid	Conceal	Disguising nonconformity
	Buffer	Loosening institutional attachments
	Escape	Changing goals, activities or domains
Defy	Dismiss	Ignoring explicit norms and values
	Challenge	Contesting rules and requirements
	Attack	Assaulting the sources of institutional pressure

[13] Resource dependence is an organisational theory developed by Pfeffer and Salancik (1978) that also considered the environment to be of importance to understanding organisations, but in a more realist sense in that organisations depend on their environment for physical and financial resources and must therefore interact with this wider social context, despite the constraints that it may impose

Strategies	Tactics	Examples
	Co-opt	Importing influential constituents
Manipulate	Influence	Shaping value and criteria
	Control	Dominating institutional constituents and processes

Source: Reproduced from Oliver (1991)

Strategies of acquiescence are adopted when organizations conform to the demands of their institutional environment which may be out of habit, imitation (similar to mimetic isomorphism as envisaged by DiMaggio and Powell (1983)) or compliance, which is an act of 'conscious obedience' (Oliver, 1991, p. 152). Compromise strategies involve more active organizational behavior, which may be to bring conflicting institutional demands into balance, demonstrating partial conformity or to assert their own interests through bargaining.

Avoidance strategies can be likened to the idea of 'decoupling', when an organization appears to be in conformity with the pressures of the institutional environment but at the same time protects the technical core of its activities from these demands (Meyer & Rowan, 1977). Presenting the 'window dressing' of acquiescence may conceal that in reality, the organization is not conforming at all. Alternatively, the organization may protect its core operations from institutional pressures through buffering. The final avoidance tactic is to exit the domain altogether, so the organization is no longer subject to the institutional demands.

A more aggressive stance is to openly defy the demands of external constituents by dismissing them, overtly challenging them or attacking the institutional source of the demands as 'an unequivocal rejection of the institutional norms and values' (Oliver, 1991, p. 157). Finally, organizations may seek to exert their power by changing the substance of the institutional demands. Oliver suggests that one tactic is to co-opt actors from the institutional source to act in the interests of the organization. Attempts to achieve influence over the agenda can be achieved by activities such as lobbying but the most aggressive and active tactic of all is for an organization to take control of the institution itself.

Oliver then goes on to suggest the environmental factors which could be used to predict the type of response an organization might select in a specific context, also taking into consideration that organization's willingness and ability to conform. The multiplicity of demands, the alignment of the demands with the organizational goals, the degree of legal coercion, legitimacy of the institution, efficiency and the level of environmental uncertainty are all cited by Oliver as predictive factors. The intention here is not to test the predictive power of these factors but to use this framework as a way of explaining the possible types of responses that emerge inductively from the fieldwork.

More recent work on organizational responses to institutional environments has emphasized the pluralistic nature of these environments, drawing upon the institutional logics perspective outlined above (Greenwood et al., 2010; Greenwood, Raynard, Kodeih, Micelotta, & Lounsbury, 2011; Kraatz & Block, 2008; Pache & Santos, 2010, 2012). Pache and Santos (2010) build on Oliver's typology to explore organizational responses to conflicting institutional demands associated with multiple institutional logics. Rather than the predictive factors presented by Oliver, Pache and Santos (2010) maintain that the nature of the institutional demands and the degree to which they are represented internally within the organization are more likely to influence the response strategy. Institutional demands may either prescribe the goals which an organization should pursue or, the specific means which are appropriate for the organization to adopt (Pache & Santos, 2010, p. 460). Where there are conflicting institutional demands, there may be varying levels of internal representation of these demands. For example, there may be no representation, or only one side of the conflict might be represented internally or there may be multiple representations of conflicting demands. What this adds to Oliver's framework is a means of exploring how organizations might deal with the conflicting demands of their institutional environment and also allows for the possibility that different organizations may respond differently to the same conflicts depending on how well represented the institutional logics are internally.

According to Greenwood et al. (2011), there are additional organizational factors[14] or 'filters' which can influence the way an organization responds to its complex institutional environment. Organization field position is the first organizational filter. An organizational field comprises

> *'those organizations, that in the aggregate, constitute a recognised area of institutional life; key suppliers, resources and product consumers, regulatory agencies and other organizations that produce similar services or products' (DiMaggio & Powell, 1983, p. 148).*

Field positions are either 'core' or 'peripheral', with core organizations tending to be those that are largest and possess considerable status. Organizations at the periphery tend to be less inclined to preserve the status quo because they are less embedded in the existing arrangements (Greenwood et al., 2011). On the other hand, core organizations are much more visible and this can have the effect of amplifying the institutional demands but at the same time, also gives them more power to influence the nature of those demands. Second, the structure of power within an organization is also likely to influence its response to institutional complexity. Related to the idea of internal representation put forward by Pache and Santos (2010), actors who occupy particular structural positions will interpret institutional pressures from the perspective of those institutional logics to which they have had the greatest exposure (Greenwood et al., 2011, p. 342). Greenwood et al. maintain that the ownership and governance of the organization can have a bearing on how receptive that organization will be to specific logics. Both the type of the owner (e.g. public versus private) and the structure of ownership (partnership, publicly traded company, not for profit) may make a difference, given how decision-making processes vary between them (Greenwood et al., 2011, p. 345).

Any discussion of possible organizational responses to environmental change must also consider organizational legitimacy, which is a core tenet of organizational institutionalism (Deephouse & Suchman, 2008). Organizational legitimacy has its roots

[14] Greenwood et al. (2011) also suggest features of the 'organizational field' that may affect response choices, however, since this research is being conducted amongst organizations occupying the same field, these have not been elaborated.

in both Weber and Parsons' sociological work (Deephouse & Suchman, 2008) and is considered key to organizational survival:

> *'organizations that incorporate societally legitimated rationalised elements [institutions] in their formal structure maximise their legitimacy and increase their resources and survival capabilities' (Meyer & Rowan, 1977 p352).*

However, the concept of legitimacy itself has experienced 'substantial plasticity' (Deephouse & Suchman, 2008 p49) but Suchman provides an inclusive and much cited definition, aptly synthesizing previous concepts of legitimacy:

> *'Legitimacy is a generalized perception or assumption that the actions of an entity are desirable, proper, or appropriate within some socially constructed system of norms, values, beliefs and definitions' (Suchman, 1995 p574).*

Legitimacy contributes to an organization's overall survival by creating continuity and credibility which interact together to enable organizational persistence. Not all organizations need to 'achieve' the same level of legitimacy, but if they are seeking 'active support' (Suchman, 1995, p. 574) then the legitimacy stakes are much higher, and more effort must be made to achieve, maintain and repair legitimacy should it be damaged for some reason.

To gain legitimacy, an organization must conform to the demands of its environment – it may seek an audience whose legitimacy demands are congruent with its current activities or it may work to manipulate the environment to create this congruency (Suchman, 1995, pp. 586-593). Because the conferral of legitimacy is an ongoing social process, organizations have to work to maintain legitimacy over time, requiring them to anticipate and monitor changes in their environment to avoid shocks which could damage their legitimacy position. Organizations may also pursue additional activities to boost their stocks of goodwill and support from their external referents (Suchman, 1995, pp. 593-597).

Perhaps of most relevance to this thesis are the strategies that organizations may employ to repair their legitimacy as 'a reactive response to an unforeseen crisis of meaning' (Suchman, 1995, p. 597). Such strategies involve creating a narrative which either denies, excuses, justifies or explains the problems that led to the legitimacy crisis.

Organizations may also choose to restructure, perhaps by inviting external scrutiny or investigations or by replacing senior members of staff associated with the crisis. Such strategies are only likely to be successful, Suchman warns, if they are performed with subtlety – heavy handed, 'knee-jerk' reactions may be counter-productive (Suchman, 1995, p. 599).

An organization operating in a pluralistic institutional environment is likely to have multiple sources of legitimacy or external constituencies identified with multiple institutional logics all of which have their own legitimacy criteria (Kraatz & Block, 2008). For example, key sources of legitimacy for a bank are the market, the regulator, its customers and even the media (Deephouse, 1996). Regulators will require banks to act appropriately, in line with the cultural, cognitive and normative aspects of regulatory logic. Its shareholders, however, will consider the bank to be legitimate if it is acting so as to maximize profits and deliver optimum returns, in line with the logic of the market. The legitimacy criteria of the market and the state are different, and may even come into conflict, resulting in a complex situation for a bank requiring legitimation from both institutional orders. In this case, Kraatz and Block (2008) suggest several options are open to the bank. These include avoiding the legitimacy demands altogether by denying their validity or invoking other strategies of defiance or manipulation (Oliver, 1991). Alternatively, the bank could pursue a 'decoupling' strategy, whereby different internal groups relate differently to the various conflicting legitimacy criteria. Finally, strategies of compromise could also be employed, with attempts to balance conflicting legitimacy demands (Kraatz & Block, 2008, pp. 250-251). Legitimacy, therefore, is an important consideration for organizations when they determine how to respond to changes or pressures in their institutional environment, particularly when that environment comprises multiple logics with multiple legitimacy criteria.

Institutionalist theory proposes a range of responses that banks may adopt in relation to their changing regulatory environment and also offers a number of explanatory factors to account for differentiated responses within an organizational field. It is also worth noting that Greenwood et al. (2011) make the important point that an organization may not adopt just one single, sustainable response over time. This allows for the possibility of multiple responses over time because ‘an organization that complied with institutional pressures a year ago may resist them today and an organization that used to circumvent a mandate may have embraced it by now’ (Tilcsik, 2010, p. 37).

Organizations, risk and uncertainty

The uncertainties associated with organizations’ environments has long been a subject for scholars of management and organizational theorists[15] (Power, 2007). Indeed, the management of uncertainty is central to the conception of an organization; ‘organizing and managing are fundamentally about individual and collective human efforts to process uncertainty’ (Power, 2007, p. 8). This is not to suppose that processing uncertainty is a straightforward and easy task to accomplish. By its very nature, in trying to manage uncertainty, organizations are trying to manage that about which they have very little knowledge. This section explores related literature on how organizations perceive and process environmental uncertainty and how they make decisions under these conditions.

Uncertainty can be thought of as having two dimensions which affect how organizations perceive the degree of uncertainty in their environments (Duncan, 1972). One dimension is the level of complexity within the environment, based on the number and heterogeneity of environmental factors considered in organizational decision making. The other dimension is the stability of these decision-making factors over time. Organizations will perceive high levels of uncertainty when their environments are complex and dynamic (Duncan, 1972, p. 325). In the post-crisis regulatory environment, not only was there a considerable volume of change, it was also highly complex, covering as it did several types of financial regulation, involving many actors across multiple jurisdictions (see Chapter 3). According to Duncan’s framework, banks would therefore perceive the post-crisis regulatory environment to be a very uncertain one indeed.

[15] See Samsami, Hosseini, Kordnaeij, and Azar (2015) for a comprehensive review of organizations and uncertainty in the strategic management literature.

It is also worth interrogating the meaning of uncertainty more closely, not necessarily to arrive at a precise definition but to understand the types of conditions that uncertainty creates for organizational decision-making. A lack of information, an inadequate understanding of that information and the inability to evaluate alternative courses of action provide the context for the managerial processing of uncertainty (Duncan, 1972; Grote, 2009; Lawrence & Lorsch, 1986). All three of these aspects have to be navigated before organizations can decide on a course of action, requiring what Weick (1995) terms as 'organizational sense-making'. Milliken (1987) goes further in specifying the types of uncertainty that organizational members might perceive – these are state, effect and response uncertainty. The first of these, state uncertainty, 'means that one does not understand how components of that environment might be changing' (Milliken, 1987, p. 136). For example, banks might not be clear about the details of the prudential regulatory rules or how different pieces of regulation may interact with each other. Secondly, effect uncertainty relates to an inability to predict how changes in the environment might affect the organization. An instance of this might be banks being unable to specify the impact that new regulatory rules might have on their future financial performance. Finally, response uncertainty occurs when organizations are unable to determine the consequences of choosing one possible response over another. This could be the case if a bank implements a new compliance management system but is not sure whether it is in line with regulatory expectations.

Uncertainty and equivocality (or ambiguity) in an organization's environment are deemed to be occasions for sense-making (Weick, 1995, p. 91) which is conceived as a collective, social process of meaning-making which enables the subsequent actions required to bring stability to organizational life. Sense-making is more about plausibility than accuracy, 'about the continued redrafting of an emerging story so that it becomes more comprehensive, incorporates more of the observed data, and is more resilient in the face of criticism' (Weick, Sutcliffe, & Obstfeld, 2005, p. 415). As a result, despite the potential lack of accuracy, it is possible to change the nature of the uncertainty over time. Stinchcombe (1990) suggests that uncertainty is 'reduced through news; then finally, the residual uncertainty is transformed into risk' (Stinchcombe, 1990, p. 5).

The idea that uncertainty can be transformed into risk is picked up by Clarke (2001) who suggests that this process of transformation is a drive towards rationalization, reflecting a 'societal-level expectation that organizations should be able to control the uncertain, and be able to respond effectively to the untoward' (Clarke, 2001, p. 12). This expectation is evident in the emergence of a 'managerial concept of risk management and the different logics and values which underlie it' (Power, 2007, p. 3). According to Power, as soon as uncertainties are organized within a framework of risk management, they are transformed into risks (Power, 2007, p. 4).

Due to the nature and complexities of organizational life, combined with the contestable and elusive nature of risk itself, this is not a straightforward task. Hutter and Power (2005) present a useful approach for understanding how organizations deal with risk through their idea of 'organizational encounters with risk'. Three distinct 'lenses' are used to explore these encounters – attention, sense-making and re-organization.

Organizational attention to risk relates to the problematization of risk, how it is measured, calculated and identified and the technologies of control that are used in these activities. Sense-making about risk is undertaken in response to 'errors, accidents and anomalies', a means by which organizations attempt to understand risks and 'transform new encounters with risk into acceptable managerial practices' (Hutter & Power, 2005, p. 19). The final perspective examines the re-organizing undertaken in response to risks, including efforts to improve their control and management throughout the organization.

This thesis will use these understandings of the organizational processing of uncertainty to explore how banking organizations attend to and gather information about regulatory change, how they respond to the equivocality and possible lack of clarity in that information and how they then make determinations of how to act and re-organize in response to those changes.

Organizations, regulation and regulators

Within the large swathe of regulatory literature on corporations and regulation (see above), of most relevance here is that which explores 'new governance' techniques[16] and their adoption within business organizations (Coglianese & Lazer, 2003; Ford, 2008; Gilad, 2010; Gunningham & Sinclair, 2009; Hutter, 2001, 2011c). These regulatory tools have been developed as an alternative to the 'command and control' regulatory strategy in the hope of achieving 'better' regulation (Baldwin, 2010; Better Regulation Task Force, 2003). Of particular interest is the technique of management-based regulation because, as established above, this best describes the approach of the Basel 2 prudential standards and the FSA's approach to supervision before 2009. For management-based regulation to be successful, the target organization has to internalize the 'constitutive' rules that comprise the regulation (Hutter, 2011c, p. 461) and do this 'to the point that there is no longer a need to refer to the law since the distinction between the rule and the ruled activity disappears' (Hutter, 2001, p. 16). Organizations are supposed to accomplish this by integrating the regulatory requirements and appropriate behavior into the corporate culture of the organization in such a way as compliance becomes a 'taken-for-granted' part of organizational life (Parker, 2002). In other words, the achievement of regulatory goals becomes institutionalized within the organization.

From her research into health and safety on the British Railways, Hutter develops a three stage model which envisages how organizations might progress towards the normalization or institutionalization of a system of enforced self-regulation[17] (Hutter, 2001, pp. 301-312). The first stage is 'design and establishment', involving activities such as responding to regulatory consultations, designing new organizational structures and processes, developing plans for change programmes and training and communication activities related to the new regulation. The second 'operational' phase sees the plans

[16] Various regulatory instruments or tools are captured under this broad heading, including principles-based regulation, risk-based regulation, management-based regulation, meta-regulation and enforced self-regulation. Though there is no one accepted classification of these techniques, Gilad (2010) has developed a useful typology which will be followed here.

[17] Enforced self-regulation is very similar to management-based regulation and is a regulatory strategy developed by Ayres and Braithwaite (1992) and combines both state and corporate regulation. The state sets out broad standards which firms must meet and which firms must monitor on an ongoing basis. However, regulatory authorities also have powers to oversee this process and enforce sanctions in instances of non-compliance.

being put into action within the organization, the systems and process changes are made and become part of "business as usual" and the awareness and compliance with risk management spreads throughout the organization. The final 'normalization' phase is achieved when 'risk management and regulatory compliance are fully integrated parts of the corporate culture' (Hutter, 2001, p. 302). This three stage model provides a useful heuristic to analyze the degree to which prudential regulation has become institutionalized within banks and how regulatory change might affect banks' progress back and forth between the three stages.

Reaching the final stage of this model is akin to a 'regulatory Utopia' (Black, 2008b, p. 432) but some scholars have warned of the potential 'pathologies'[18] of new governance techniques (Parker, 2002), the possibility of unintended consequences (Gray & Hamilton, 2006) and the paradox inherent in its reliance on firms to have the ability and willingness to design appropriate internal systems, processes, controls and cultures (Black, 2012a). This study is therefore open to the possibility that there may be both internal and external factors that may hinder this process, and that by identifying these, Hutter's model can be further developed.

This thesis considers regulation and regulatory supervision (understood as compliance monitoring and enforcement) as an inherently social process (Colebatch, 1989; Hawkins, 1984; Hutter, 1997; Meidinger, 1987). Whilst for convenience, regulatory authorities and regulated organizations are often referred to in the aggregate, as if they are actors in their own right, it is more accurate to view them as comprised of many individuals and constituencies of individuals that comprise a 'regulatory community' (Meidinger, 1987). In this sense, regulatory interactions are not depersonalized, anonymous occurrences, rather they happen between people, and often between the same people as encounters are repeated over time (Hawkins & Hutter, 1993). The need for repeated interactions is created by the interdependent nature of the regulatory relationship. As Hawkins puts it, regulators and the regulated 'depend on each other for information and assistance'

[18] Parker (2002) suggests four possible pathologies that can arise a s a result of the conflict between business and compliance goals: ceremonial compliance, shifting responsibilities and risks, scapegoating and stakeholder containment (Parker, 2002, pp. 144-164).)

(Hawkins, 1984, p. 45). Regulatory inspectors or supervisors cannot be expected to know every detail of the regulated organization's business. In the case of bank regulation, significant asymmetries of information arise from the nature of the bank's role as an intermediary between borrowers and lenders. Only the bank is privy to the specifics of these transactions and more importantly, to the risks associated with them. But the information does not flow one way, banks are also reliant on their supervisors for guidance and assistance in the implementation of regulatory standards, particularly when they take the form of new governance techniques (discussed above). Regulatory capture theorists warn of the downsides of this interdependence (Stigler, 1971) but it is an inevitable result in situations where both sides of the regulatory relationship require information from each other.

Ethnographic studies of regulatory inspectors and the organizations which they inspect (Hawkins, 1984, 2002; Hutter, 1997, 2001) have revealed that the repeated encounters or interactions result in a kind of reflexive relationship, characterized by 'a continual process of adaptation and readaptation by one party and then the other according to responses received' (Hawkins & Hutter, 1993, p. 203). The influential theory of responsive regulation (Ayres & Braithwaite, 1992) and the extensions of this by Black and Baldwin (Baldwin & Black, 2008; Black & Baldwin, 2010) also considers the reflexive nature of the interpersonal dynamics between the regulator and the regulated. Here, adaptions are central to the enforcement strategies adopted by the regulator and how the nature of compliance and non-compliance is perceived. The responsiveness here comes from the way in which the regulator views the regulatee and how this then influences the regulator's approach to enforcement, possibly responding in a tit-for-tat way depending on how compliant and co-operative the regulatee is considered to be (Ayres & Braithwaite, 1992).

Various theoretical and empirically derived typologies have been developed to classify firms according to their perceived dispositions towards compliance with regulation (Baldwin, 1995; Kagan & Scholz, 1984). Other factors can (or should) also influence how a regulator characterizes a regulated organization based on the regulated organization's behavior, attitude and culture (Baldwin & Black, 2008; Black & Baldwin, 2010). Through their encounters with the regulator, regulatees create their own understandings of the regulator. Gray and Silbey (2014) have identified three variants of how regulators might be regarded – as threat, ally or obstacle. These characterizations of the regulator vary within an organization, depending on the expertise, role in the organizational hierarchy and the frequency of regulatory interactions of the organizational members.

Given this propensity to identify and label the 'character' of the other party in the regulator / regulatee relationship, the smallest details of these interactions can become significant. The following passage from Hutter's work on environmental inspectors illustrates this point:

> *'Inspectors interpreted the reception they received from the regulated according to the nature of their relationship. For instance, difficulties in parking could be interpreted as a company being awkward or as an understandable pressure on parking. Being asked to sign a visitor's book would be seen either as a sensible precaution in case of fire or as obstructionist and rude. Inspectors also reacted differently to offers of coffee and lunch according to the social distance they wished to maintain between themselves and the regulated. Where there was a close and co-operative relationship inspectors would expect to be offered coffee and possibly lunch.' (Hutter, 1997, p. 188)*

The converse is also likely to be true, that small nuances in the regulator's behavior can influence how the regulated organization responds. These 'relational signals' are characterized by ambivalence (Etienne, 2012, p. 31), adding to the uncertainty experienced by the regulated. However, this uncertainty can be reduced through repeated interactions resulting in both the regulator and the regulated sharing 'a common understanding' of their relationship. Moreover, this provides a basis for the proactive management of the relationship by both parties (Etienne, 2012).

The continued development of the relationship between the regulator and the regulated produced by repeated interactions may also cause this relationship to become increasingly cooperative (Pautz & Wamsley, 2011, p. 6). Opinions in the literature vary as to the benefits of a cooperative regulatory relationship – some claim that such cooperation can increase regulatory effectiveness (Bardach & Kagan, 1982; Pautz &

Wamsley, 2011; Scholz, 1991) whilst others suggest that close ties can lead to subtle forms of regulatory capture or even the tolerance of deviant behaviour, to which the regulator turns a blind-eye (McCaffrey, Smith, & Martinez-Moyano, 2007; Vaughan, 1997). Notwithstanding this debate, the representation of the relationship between the regulator and the regulated as being deeply interpersonal and interdependent, possibly co-operative and continual over time provides a valuable foundation from which to explore post-crisis regulatory relationships.

Thesis outline

This thesis continues with Chapter Two which explains the research methods used in the study, why they were appropriate, how the data was sampled, collected and analyzed. It also discusses ethical considerations and the methodological limitations of the research.

The next five chapters comprise the empirical part of the thesis, beginning with Chapter 3 which provides a more detailed explanation of the rationale for prudential regulation and how prudential regulatory standards have developed over time. This chapter also explains the key regulatory changes to prudential regulation that have resulted from the financial crisis. Because of the interconnections between global rule making and national implementation, this chapter describes the key changes at an international, EU and UK level, drawing out the complexities of this process. These changes included not only the changes to the regulations themselves, but also to the cognitive frames and intellectual assumptions which underpinned prudential regulation prior to the crisis and the approach to the supervision of banking organizations in the UK.

Having set the empirical stage, Chapter Four presents the findings from the discourse analysis work, which explores how the five largest UK banks responded to regulatory change in their annual reports and regulatory consultation responses over the period 2006-2013. This chapter does two key things. First, it analyzes banks public discourses about regulatory change, highlighting the presentation of their organizational selves in relation to regulation and how this changed over time. Second, it reveals that the institutional logics of the market and regulation were the dominant logics used by the banks in their public discussions of regulatory change, but the balance struck between their use changed over time in relation to considerations of legitimacy, levels of uncertainty and organizational characteristics.

The fifth chapter uses the data from fieldwork interviews to explore the material practices and structures of managing regulatory change as a risk. It explores where the responsibilities for managing regulatory change lie within large, complex banks and how these have been adapted in the post-crisis environment. Ten core categories of regulatory practices are identified over the regulatory life-cycle (from initial legislative proposals through to ongoing compliance monitoring). These practices are examined in terms of banks attend to the risk of regulatory change, how they make sense of those changes and the re-organizing activities implemented to control the risks of regulatory change.

Chapter 6 also draws on the interview data and considers the routine interactions between the bank supervisors and actors within the banks themselves. It demonstrates that the nature of these relationships varied over time and were influenced by broader political and economic circumstances. The final substantive chapter uses Hutter's model of corporate responses to regulation (Hutter, 2001) to investigate the institutionalization of post-crisis regulatory changes within banks. The interview data revealed several indicators of regulatory institutionalization as well several internal and external factors that can help or hinder this process.

The final concluding chapter presents the key thematic arguments that emerge from the findings in the empirical chapters and discusses them in relation to the contribution this study makes to the sociological and socio-legal literature about risk, regulation and organizations. The chapter finishes with a discussion of the study's limitations and maps out the implications of this thesis for future research.

Chapter 2: Research methodology

The purpose of this chapter is to explain how the research questions and aims presented in Chapter 1 were translated into the methodological approach. It explores the epistemological and ontological underpinnings of the study and how the theoretical orientation informed the selection of methods for analyzing and collecting data. The practicalities of the processes used to conduct the fieldwork are then described. Finally, the chapter considers how issues such as ethics and researcher positionality were taken into account, especially the latter given the researcher's prior experience of working in the financial industry.

Qualitative research methods were the most appropriate choice for this study because of the project's conception of regulation as a social process and the focus on meanings and interpretations. The aim was not to test pre-determined hypotheses nor to confirm or negate a specific theoretical position, therefore this thesis took an inductive approach to the data. The epistemological basis of this inquiry arises in both neo-institutionalist organizational theory (Phillips & Oswick, 2012; Scott, 2007) and the sociological conceptions of risk (Hilgartner, 1992; Lupton, 1999a; Renn, 1992; Zinn, 2008) which draw on social constructionism (Berger & Luckmann, 1966; Gergen, 1999) and its concern with how knowledge about the world is gained. This perspective holds that what is understood as reality, and the information that is available about that reality, is created through social interactions. That is not to say that there isn't some 'objective' reality outside these social constructions, rather that this reality can only be made sense of and given meaning through relationships and use of language and other semiotic resources. Indeed, Berger and Luckmann (1966) stress the notion of 'institutionalization', a process whereby meanings are stabilized through the production and repetition of actions over time, largely through the use of language. Qualitative methods, therefore, allow for such understandings and meanings to surface in the fieldwork data and the texts produced by the banks themselves (see below).

The research design also had to consider more pragmatic matters associated with the specific empirical context. Banks and the banking industry had been a frequent, almost daily, topic of media scrutiny since the financial crisis and were also subject to significant political scrutiny. Such factors, combined with the confidentiality and sensitivity of regulatory matters, meant that the researcher had to establish relationships of trust to negotiate access and guarantee anonymity, as well as respecting the other time commitments of the participants.

Two qualitative research methods were used – discourse analysis on bank annual reports and regulatory consultation responses and semi-structured interviews with representatives from banking organizations. The temporal boundaries for the period of data collection were determined by considering the timing of the crisis and the post-crisis regulatory reforms (see Chapters 1 and 3). However, accounts of the crisis timeline vary as to its precise duration (Edmonds, 2010; Guillén, 2009; New York Federal Reserve Bank, 2011). This project therefore takes the period from mid-2007 to the end of 2009 as the period of the financial crisis, and considers the regulatory changes from 2008 onwards (see Chapter 3). The fieldwork interviews were conducted between 2013 and 2014 and the documentary data analysis sample covered the years 2006-2013 (see below)[19]. The initial focus was on the discourse analysis, followed by the interview fieldwork but some of the work was done in parallel.

Discourse analysis

The purpose of the discourse analysis was to understand what banks themselves were publicly (or officially) saying about financial regulation and regulatory change during the period under investigation (2006 – 2013). Texts produced by the banks were examined using discourse analysis techniques to identify the different ways in which they discussed regulation and regulatory change.

[19] The aim was to complete the fieldwork interviews and discourse analysis by the end of 2013, however, due to access issues, some interviews had to be scheduled in early 2014 hence the discrepancy in the end dates for data collection between these two methods.

Corpus construction

Three general criteria were applied to selecting the texts that comprise the discourse analysis corpus. The first follows one of the important principles of discourse analysis in that the texts under analysis should be naturally occurring so that 'data are in principle not edited or otherwise 'sanitized' but studied 'as is', that is, close to their actual appearance or use in their original contexts' (Van Dijk, 1997b, p. 29). Secondly, given the sensitivity relating to regulatory matters, it was unlikely that access would have been granted to private documents regarding regulation, so the documents had to be available publicly. Finally, and most importantly, the documents had to have enough content that related to financial regulation to make their analysis meaningful. Two classes of documents were identified – annual reports and responses to regulatory consultation papers.

Annual reports are produced as a legal requirement by all public companies in the UK and their content is largely dictated by company law, financial reporting regulations and accounting standards. However, there is also a significant element of discretion allowed in the narrative and therefore they also serve other purposes for the firm as ‘part of a corporate communication strategy that pursues strategic objectives, such as strengthening the corporate image or brand, or seeks to strengthen other marketing objectives with particular stakeholders’ (Stanton & Stanton, 2002, p. 496). The ‘stakeholders’ that are the audience for these reports include the shareholders of the company, employees, customers, suppliers and various other publics such as the media, investor analysts and regulators that have an interest in the contents. Annual reports provide a fertile ground for discourse analysis as they consist of several different textual ‘genres’ compiled together in one document. They combine narrative text with financial information, graphs, tables and visual imagery and often run to hundreds of pages. It was therefore necessary to apply some parameters to obtain a sample that was manageable and created some uniformity and comparability across the corpus.

The annual reports were sampled along two different dimensions. Firstly, the time frame for the documentary analysis was from 2006 to 2013. 2006 was chosen as a starting point so that banks' responses to regulatory change and how they might have altered before, during and after the financial crisis could be examined. Secondly, the population of all possible annual reports produced by banks in the UK needed to be narrowed to specific organizations to make the analysis feasible in the available research time. particular organizations. The largest five UK banks – Royal Bank of Scotland, HSBC, Lloyds, Barclays and Standard Chartered were chosen because they occupied the same organizational field (DiMaggio & Powell, 1983) and also represented some diversity in terms of geographical coverage, products and types of customer. The sample also includes banks that had and had not received UK government support during and after the financial crisis. Table 2.1 shows these characteristics for each of the five banks.

Table 2.1 Characteristics of sample banks

Bank	Size (Assets, £bn)	State Help	Key Markets	Customers
Royal Bank of Scotland	1027.9	Yes	UK Europe Middle East Americas Asia	Retail Commercial Wholesale
HSBC	1602.8	No	UK Europe Hong Kong Rest of Asia-Pacific Middle East & North Africa North America Latin America	Retail Commercial Wholesale
Barclays	1312.3	No	UK Europe Africa & Middle East Americas Asia	Retail Commercial Wholesale
Lloyds	847	Yes	UK	Retail Commercial
Standard Chartered	404.6	No	Asia Africa Middle East	Retail Commercial Wholesale

Source: Bank Annual Reports, 2013

Whilst many internationally active banks are incorporated in the UK, focusing on the top five of UK origin enabled greater comparability between the documents as the legal requirements for the annual reports and the regulatory situations of the banks are similar. An additional complicating factor is that annual reports are produced for bank legal entities at different levels of the company hierarchy[20]. Only the annual reports for the top level of this hierarchy were examined as these provided the best comparison across the five banks.

This resulted in a sample of forty annual reports for these five organizations which were downloaded from their websites and given a preliminary reading to identify the sections to include in the scope of the discourse analysis. If any sections in the report contained references to regulation or regulatory change in any year for any of the five banks they were included in the corpus[21]. The sections identified were:

Chairman's statement: This is presented as a letter from the Chairman of the Board of the bank to the shareholders. This section provided an insight into how the Chairman communicated understandings of the events of the prior year and the priorities of the organization for the year ahead. This section revealed the issues that were commanding the most organizational attention for that reporting period.

CEO statement: As the figurehead of the business, the CEO is responsible for the performance of the business over the preceding year. This section was therefore deemed relevant as it highlighted regulatory issues that affected business performance and that may have been of concern in the future.

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[20] Large corporate organizations have complex company hierarchies, comprising subsidiary companies which are established as legal entities in their own right. The legal entity at the top of the hierarchy is the holding company and it is at this level that the overall prudential capital requirements are measured.

[21] Content deemed out of scope of the discourse analysis included all quantitative data tables, all non-risk and financial business performance commentary, the financial accounts and notes to the accounts, the reports from the Board committee and the Directors' Remuneration Reports. Furthermore, only narrative text was included in the analysis of the sections named above, all tables of financial data were explicitly excluded as not being relevant to the research question.

High-level risks (principal risks): This section typically identified a bank's assessments of the high-level risks to which it was exposed, which varied from market conditions, the macro-economic outlook to regulation and regulatory change.

Risk management / risk review: All the bank annual reports contained detailed sections regarding risk management in which they presented their policies and procedures for managing different risk types and also provided quantitative data regarding risk exposures for the prior year.

Regulation and supervision: This section typically contained information about the bank's supervision, the regulations to which it was subject in its various jurisdictions and relevant changes in regulations.

Consultation papers are produced by policy-makers and standard setters such as the BCBS, the EU and the UK financial regulatory authorities when new pieces of regulation are in the process of being developed. These lay out the proposed changes and invite responses from any interested parties. Policy-makers are usually mandated to release these consultation papers in the interests of transparency and democracy and any organization or individual is permitted to submit a response. In general, respondees to regulatory consultations include private individuals, academics, industry bodies and trade associations, and individual firms. These responses are collated and reviewed, and further consultation papers may be released or the rule-making body will progress to confirming the changed rules in a final version of the text. Consultation responses are usually made publicly available unless the respondent has requested they be kept confidential[22]. Being easily accessible, these documents were especially useful for this research project because they provided a direct insight as to how organizations are responding to particular aspects of regulatory change.

Consistent with the discourse analysis of the banks' annual reports, the same five banking organizations were also used to create the sample of consultation responses. A 'long list' of all the relevant consultation papers related to prudential regulation

[22] The exception to this was the FSA / PRA which did not publish individual consultation responses on its website. Instead, these were obtained by requesting them directly from the PRA.

produced by the relevant rule-making bodies (BCBS, the EC and the PRA / FSA) since the financial crisis was created. Second, these responses were classified according to the banks that had responded to each paper. Where three or more of the sample banks had provided a response, these were included in the corpus. The final corpus for the discourse analysis of both annual reports and consultation responses comprised 82 documents and is shown in Appendix 1.

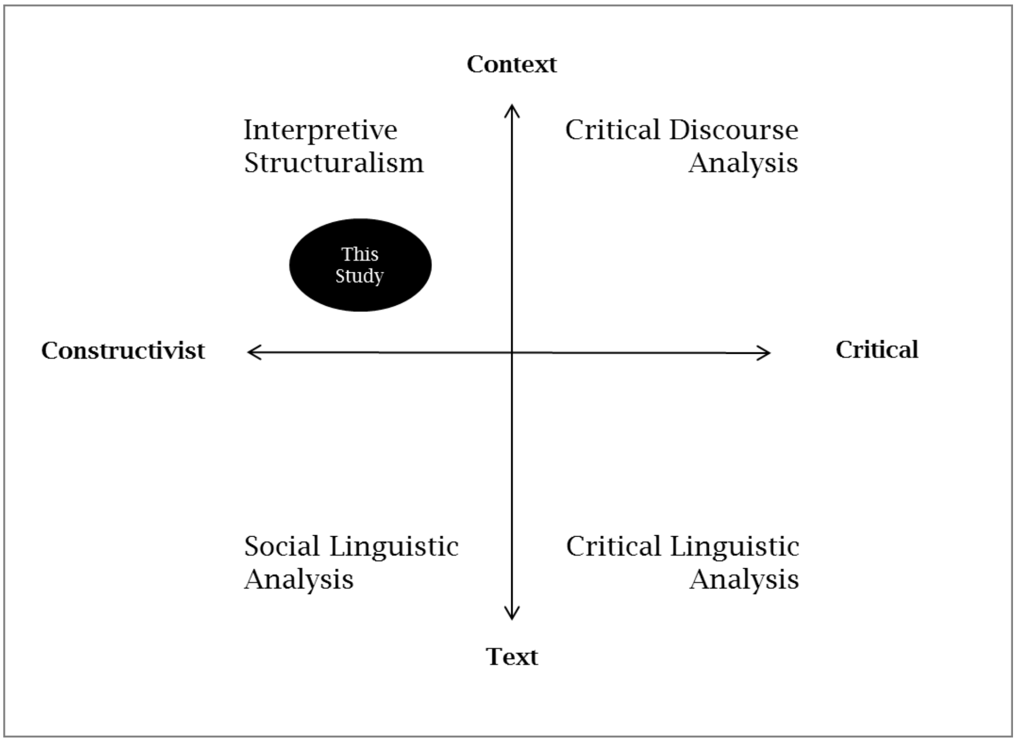
Analysis

As a method, discourse analysis allows for a closer examination of 'language as constitutive and constructive rather than reflexive and representative' (Phillips & Hardy, 2002, p. 13). This follows the moderate social constructionist 'claim that the social world is textually constructed' (Fairclough, 2003, p. 9) but not a radical claim that objects in the world or subjects of knowledge are nothing but social constructions (Sayer, 2000, p. 90). In this understanding, language and texts are 'sites in which social meanings are formed and reproduced, social identities are shaped and social facts are secured' (Tonkiss, 2004).

Discourse analysis has a diversity of approaches, from detailed textual analysis used in linguistics to critical discourse analysis (Fairclough, 2003; Wodak & Meyer, 2009). The latter is concerned with how language constitutes the unequal distribution of power in society. Hardy and Phillips (2002) offer a useful framework which has been used to locate this study within this variety of approaches to discourse analysis arranged along two axes. The horizontal axis represents a continuum between constructivist approaches and those of critical discourse analysis. The vertical axis signifies the degree to which the analysis is concerned with the fine-grained detail of a text, as in conversational analysis (Myers, 2000) or whether the context surrounding the text is of greater importance.

Figure 2.1 shows where the present study is situated in this classification, with the orientation towards a constructivist epistemology and towards the importance of the context within which the texts are situated. The contextual setting of these texts goes to the heart of the project aim of understanding and exploring how an organization experiences and contends with modifications in its external environment i.e. the changes associated with prudential regulation since the financial crisis.

Figure 2.1 Hardy & Phillips' typology of discourse analysis approaches



Source: Adapted from Hardy and Phillips (2002)

Organizational and management scholars have increasingly turned to discourse analysis to explore organizational phenomena (Alvesson & Karreman, 2000; Grant & Iedema, 2005; Phillips & Oswick, 2012) such as identity, strategy organizational change and institutions (Phillips & Oswick, 2012). Indeed, proponents of institutional theory frequently employ discursive methods of investigation. These methods are used to both understand institutional mechanisms and to provide insights into particular institutional cases, which 'open[s] up the "black box" of institutional processes in a way that other methods of empirical investigation cannot' (Phillips & Oswick, 2012, p. 449). This method is therefore appropriate for this study because it is concerned with how banks are constructing their responses to regulatory change using various rhetorical devices and particular language structures.

Discourse analysis does not have the same kind of standardized practical approach as other types of qualitative data analysis and this can be advantageous because the analysis can be tailored specifically to the particular research study. To guard against other aspects of methodological discipline such as reliability and validity being compromised, the analysis was performed in a rigorous manner, using a detailed, inductively derived coding framework and analytic memos to capture decision making and reflections during the analysis process.

The approach to discourse analysis used in this study, therefore, was an amalgam of several techniques that were deemed most appropriate given the texts involved and the core research questions. The types of discursive features that were interrogated in the texts included the following:

Key themes and arguments: The key themes and sub-themes regarding regulatory change were identified. The various lines of argument relating to these themes were analyzed and considered in relation to wider societal discourse (Gill & Whedbee, 1997; Phillips & Hardy, 2002; Tonkiss, 2004; Van Dijk, 1997b).

Variation and consistency: The texts were analyzed for patterns of variation and these were examined in terms of what they indicated about potential conflicts and inconsistencies in the texts (Gill, 2000; Potter & Wetherell, 1987; Tonkiss, 2004).

Use of language and tone: The specific lexical constructions used to discuss regulatory change were investigated, particularly where the use of jargon appeared to be taken for granted. The use of euphemistic language was also noted, as was the use of metaphor and other stylistic tropes. Finally, repetition of certain words and phrases was also considered and related back to the key themes and arguments (Fairclough, 2003).

Characterization of actors: Particular ways of portraying various actors (such as the bank, its customers or shareholders) or phenomena (such as regulation or risks) were identified and the textual devices used to construct identities were also considered (Fairclough, 2003; Gill & Whedbee, 1997; Phillips & Hardy, 2002).

The whole corpus was analyzed using the same process and coding framework and the analysis was performed inductively. The texts were allowed to ‘speak for themselves’ rather than imposing a pre-determined schema onto the data. The coding was conducted in two phases (Saldaña, 2012). The initial phase of coding was performed in a 'bottom up' manner, identifying individual elements that discussed regulatory change or regulation and these elements were assigned a descriptive code. During this first phase, approximately 2,400 textual elements about regulatory change were coded. In the second phase, NVivo (a CADQAS software programme) was used to create a hierarchical coding frame which allowed the first phase coding to be refined. This involved grouping together and integrating the codes from the first phase in a way that allowed them to be linked to possible explanatory concepts derived from the theoretical literature discussed in Chapter 1. For example, 106 references were found in the documents that discussed regulatory change in relation to the economy. These were aggregated into the category 'economic impacts', which in turn was assigned to a higher level grouping called 'market logic'. Categories of codes that directly linked to theoretical concepts therefore emerged inductively from the second phase of the data, allowing patterns that had emerged inductively to be linked to theoretical explanations.

Semi-structured interviews

The use of qualitative interviews to gain a 'fine-textured understanding of beliefs, attitudes, values and motivations in relation to the behaviors of people in particular social contexts' (Gaskell, 2000, p. 39) is a well-established method in sociology, and the most appropriate method for gathering individual views, perspectives and opinions from members of banking organizations to explore the study's research questions. Given that a research interview is also a communicative interaction where the researcher takes an active role, the researcher paid careful attention to her own role in co-constructing the interview. The use of a reflective fieldwork diary allowed the researcher to refine her interviewing techniques as the fieldwork progressed and provided a mechanism for helping to maintain critical distance from the field (see below).

Sample selection and access

Initially, the research design had been to use a case study approach, investigating two comparable banking organizations in some depth. The aim was to perform twelve to fifteen interviews in each organization, selected by purposive sampling based on where in the organization they worked. Participants at different levels in the organizational hierarchy were to be interviewed to explore variations in risk and regulatory understandings throughout the organizations.

Two potential candidate fieldwork sites had been identified – both were large, internationally active banks subject to significant prudential regulatory requirements. Access was granted for the first site and twelve interviews were secured. However, in the case of the second proposed site, the access request was escalated to the executive management of the bank who unfortunately refused. They judged their organization's participation in project to be too risky due to ongoing regulatory issues and had questioned whether the research methodology would represent a consistent picture of the organization's perspective on regulatory change[23].

The case study approach was therefore revisited, as it had not proved possible to gain a comparable level of access to any other organizations. Instead, the sampling strategy was amended to widen the number of organizations in the sample and to reduce the number of interviews per bank. Interviewees were to be selected from specific functions, all of which were relevant to prudential regulation in some way. The sample also focused, where possible, on the Group Central and Wholesale Divisions of the bank. The focus on wholesale rather than retail banking was primarily driven by the changes in prudential regulation since 2008, which tended to focus more on wholesale and capital markets than on retail banking.[24]

The following are the areas of banking organizations that were identified as having some level of interaction with prudential regulation and regulatory change.

Risk Management is responsible for the day-to-day risk management of the firm and typically split into the various risk types of market, credit and operational risk (see Chapter 3). Risk managers monitor and manage the exposure of the bank to these risks

[23] This latter concern was especially interesting, given the study's aspiration to explore differential understandings of regulation and regulatory change within organizations.
[24] Though there have also been some major changes in regulation that have impact retail banking such as the Retail Distribution Review, these tend to be more focused on conduct or consumer protection regulation under the purview of the Financial Conduct Authority.

in compliance with the prudential regulations to produce the inputs to the regulatory capital calculations.

Regulatory Affairs consists of staff who are usually responsible for managing the day-to-day liaison with the banks' regulators, keeping records of all meeting with the regulators and briefing senior management in advance of regulatory meetings. In addition, this department may be responsible for monitoring the development of new regulatory rules and ensuring that the business areas are aware of the potential changes and impacts on the firm.

Prudential Regulatory Policy / Advisory comprises employees who advise other parts of the business on more detailed regulatory issues, such as the compliance of particularly complex transactions with the regulatory rules. Advisory staff also provide guidance on the interpretation of new rules and potentially understanding the detailed impact of the changing rules on the business.

Finance functions include teams who are responsible for capital management processes which are directly impacted and influenced by prudential regulation. These processes include capital planning as well as the production of mandatory regulatory reports disclosing the bank's capital and liquidity position and other information related to the measurement and management of risk. Regulatory reports must be provided on a regular basis to the PRA. Finance staff may also be called on to explain the resulting numbers internally, to help the business understand the use of the bank's capital, for example.

The researcher employed a tactic characterized by Shenton and Hayter as the endorsement of a 'known sponsor' (Shenton & Hayter, 2004, p. 224) to gain access to interviewees. The researcher applied 'snowball sampling' using personal and professional networks. This approach secured interviews with individuals in four banks in addition to the initial organization and these respondents invited other appropriate colleagues to participate. This proved particularly effective as it allayed prospective informants' concerns regarding anonymity and endorsed the researcher's credibility and integrity.

Gaining access to the required number of research participants from banking organizations, in an environment of considerable sensitivity, required careful planning, flexibility and tenacity. The strategies employed were ultimately successful and in total twenty-two interviews were conducted from October 2013 to May 2014 broken down as shown in Table 2.2[25].

Table 2.2 Interview sample summary

Bank	Function	Number of Interviewees
A –International Universal Bank	Risk Management	5
	Regulatory Affairs	4
	Finance	3
B – International Custodian Bank	Risk Management	1
	Regulatory Affairs	1
C – UK Subsidiary of European Bank	Risk Management	2
	Finance	2
	Regulatory Affairs	1
D – Large International Bank	Regulatory Affairs	2
E – Large UK Bank	Regulatory Affairs	1

Moving from an in-depth case study in just two banks to a sample of five organizations with fewer interviews per bank had implications for the overall project and the nature of the data that was collected. For example, it was harder to investigate the variability of understandings of risk and regulation within an organization (Hutter, 2001). In instances where there were only a small number of respondents per organization, such variability was harder to observe and validate. However, the wider spread of organizations allowed for more analysis at the organizational field level and potential for more cross-organizational comparisons.

Developing the interview guide

A guide for the interview was prepared prior to the interviews, based on the research questions, the empirical context and the relevant academic literature. Given that the overall approach of the study was interpretive and inductive, allowing themes and even

[25] Please note that the researcher had previously had contact with 14 out of the 22 interviewees prior to the beginning of the research project.

potentially theoretical points to emerge from the data, the topic guide was 'lightly' structured (Wengraf, 2001, p. 60). It consisted of broad questions to encourage detailed and wide-ranging answers which gave the researcher the flexibility to adapt the conversation to the specific information that arose. The final version of the interview guide can be found in Appendix 2.

Crafting the interview questions themselves required careful consideration of language and heavily theoretical or academic terms were avoided to prevent alienating the interviewees (Gaskell, 2000). Instead, questions were couched using more business-oriented language. This proved to be advantageous in two ways. First, it created an immediate rapport between the researcher and the participant and second, as Wengraf (2001) suggests, even if the answer given was not particularly relevant to the interview question, it might contain useful data for the overall research questions.

The final consideration was the sequencing of the questions. The first few questions required the respondent to give descriptive, factual answers about their job within the organization, designed to put them at ease before asking more substantive questions. Again, this was a successful strategy for building trust during the interview, as well as producing valuable data.

Conducting the interviews

Once access was confirmed, interviews were arranged individually with participants and the interviews were conducted at their business premises or in a more neutral space according to the interviewee's preference. Informed consent was gained in writing from each interviewee prior to starting the interview. The topic guide was used as a basis for the interviews, but adapted as necessary depending on the nature of the participant's role in the organization. For example, some interviewees did not come into contact with the regulator at all in the course of their work. In these cases, the conversation naturally focused more on the changes to the regulatory rules and the respondent's opinions and experiences of managing those changes within the organization. Each interview lasted for approximately one hour and where consent was granted, the interviews were recorded. Otherwise, the researcher made detailed notes during the course of the interview. The researcher made a point of maintaining 'double attention' during the course of the interviews (Wengraf, 2001, p. 194), attending to both the substance of the interviewees' answers as well as managing the overall interview within the time constraints.

Analysis

The completed interviews were transcribed using standard orthography, omitting the paralinguistic characteristics as the analysis was focused on the thematic content of the interviews and other conversational behavior would not be analyzed (Kowal & O'Connell, 2004).

After careful reading and re-reading of each transcript, the coding and analysis was also performed using NVivo. Some initial categories for coding had emerged during the transcription process and others were derived from the relevant literature. However, the largest proportion of the coding framework was arrived at inductively as each transcript was read and coded. When approximately one third of the interviews had been coded, the framework was rationalized and given a hierarchical structure to better identify the high level analytical categories on which to base the findings.

Once all the interviews had been coded, the researcher once again left a period of two months before re-checking the consistency of the coding which created some critical distance and contributed to the validity of the analysis.

Ethical considerations

Given the sensitivity of the context, it was critical that the researcher demonstrated trustworthiness and integrity in all her dealings with the participants and the banking organizations to which they belonged. To adhere to these important ethical standards the following steps were taken before, during and after the interviews were conducted.

Firstly, at the beginning of each interview, both the researcher and participant read and signed copies of an Informed Consent form which outlined the provisions for the protection of the identity of the participant, their right to withdraw from the process at any time and how the resulting data would be used and kept secure. All interview transcripts, recordings and notes were password protected and stored in private folders to which only the researcher had access. If hard copies were made, they were kept in locked filing cabinets.

The researcher was very careful to keep the identity of other participants confidential, even with members of the same organization. Similarly, no reference was ever made to the identity of the other participating organizations. Finally, the identities of participating organizations and individual interviewees have been completely anonymized in the entirety of this thesis,

Managing two data sets

The fieldwork and analysis resulted in two discrete data sets analyzed according to two distinct coding frameworks and methods. The discourse analysis provided an 'organizational field' level view of the banks' public responses to regulatory change, highlighting areas for further exploration in the interview data. No attempt was made to match or perform a direct comparison between the two data sets given that the sample organizations were different in each case. However, by comparing the more general themes and evidence that emerged from one set with the other, similarities and variabilities were identified and interrogated. This gave the researcher a broader and better view of different perspectives and understandings.

Researcher positionality and reflexivity

As discussed at the beginning of this chapter, the researcher had previously worked in the financial industry. Despite having this previous 'insider' experience, the researcher recognized the importance of maintaining critical distance with respect to the data collection and analysis. The importance of researcher reflexivity in qualitative research, and in particular on qualitative research in organizations, is well documented (Cunliffe, 2003; Haynes, 2012; Hibbert, Coupland, & MacIntosh, 2010). Described by Haynes, reflexivity is 'an awareness of the researcher's role in the practice of research and the way this is influenced by the object of the research, enabling the researcher to acknowledge the way in which he or she affects both the research processes and outcomes' (Haynes, 2012). Given the interpretive epistemological and ontological basis of this study, it is vital that reflexivity 'is used here to question knowledge claims and enhance understanding by acknowledging the values and preconceptions that the researcher brings to that understanding' (Haynes, 2012, p. 72).

Several strategies were employed to enable this reflexive process and to maintain critical distance including the use of a fieldwork diary, using theory from the relevant academic literature to analyze and interpret the data and listening to the interviews themselves several times to understand how the data had in part been co-constructed. Much of this reflection focused on the positionality of the researcher herself, along the insider-outsider continuum (Haynes, 2012, p. 201)

Insiders are defined as 'the members of specified groups and collectivities or occupants of specified social statuses' (Merton, 1972, p. 21). This gives the insider *a priori* knowledge of, and familiarity with, a particular social setting, which can have both advantages and disadvantages for scholarly research. The researcher in this case was no longer an insider, having left the industry a year prior to conducting the fieldwork. However, given her previous acquaintance with several of the interviewees, it was very likely that they may still have viewed her as an insider. This required careful handling in the interviews themselves (see below).

Despite the disadvantages documented by Hockey (1993), (over-familiarity or the potential for bias) the previous insider status of the researcher was advantageous in terms of securing access to the financial industry, which has been a problematic industry within which to conduct academic research. The familiarity of the researcher with the subject matter of the interviews also added to her credibility and enabled her to build significant levels of trust with the participants, resulting in candid interviews and a rich set of data. Several of the interviews were with senior members of banking organizations, usually with very busy schedules, and the researcher's existing level of knowledge enabled the interview to explore substantive issues rather than the interviewee having to explain basic concepts.

Notwithstanding these benefits, the researcher was careful to use techniques to mitigate the potential drawbacks of over-familiarity. These centered around 'making the familiar strange', questioning the researcher's own taken-for-granted assumptions and preconceptions. The primary mechanism for this reflection was a fieldwork diary in which observations and thoughts were recorded as soon as possible after each interview was completed. One of the most consistent observations was the need for the researcher to ensure that the tacit knowledge that the interviewees possessed was rendered explicit in the course of the interview. To overcome this, at the beginning of the interview, the researcher emphasized that the participant should not assume that the researcher possessed any prior knowledge. In addition, in cases where the researcher's knowledge was taken for granted, the interviewee was asked to elaborate and/or provide specific examples of the phenomena under discussion.

Once all the interviews were completed and transcribed, the researcher focused solely on the documentary data analysis for three months, putting some temporal distance between her exit from the field and the analysis of the interview data. During the analysis process, the researcher approached the data with an attitude of open curiosity. Additionally, by using inductive analysis informed by theory, and allowing the coding framework to emerge from the data, the risks of researcher bias and the application of an insider perspective were minimized.

Limitations

The translation of a well thought out research design into the practical activity of conducting fieldwork is not straightforward because of the 'messiness' of the real world, and the constraints that this places upon the research project. Thus, the methods that are applied are always, to some degree, a result of pragmatism and compromise. In the case of this current study, several of the difficulties encountered in conducting the fieldwork have already been mentioned but it is worth reflecting on how these limitations have shaped the resultant research.

Firstly, the use of discourse analysis is inherently an interpretive practice, the researcher bringing to it her own assumptions, situation, experience and understandings of the world. Thus, whilst every effort was made to introduce rigour in the coding process to increase the reliability of the findings, they are this one researcher's interpretation of the data. This is, however, not an insurmountable problem for this study as in the main, the results were triangulated where possible with secondary data sources, adding reliability to the findings overall (Flick, 2004).

Second, the biggest compromise that was made to the original research design was changing from an in-depth case study approach to a broader but shallower sample. This was due to the concrete realities of gaining access to organizations in a particularly sensitive context and whilst it required a change in approach, the resultant data from the five organizations was no less useful or interesting. Indeed, it has resulted in findings which are suggestive of phenomena applying across the organizational field.

Finally, a trade-off had to be made between protecting the anonymity and confidentiality of the interviewees and participating organizations and the interesting data and findings that emerged as result of their own unique positions vis-à-vis the regulators (Miles & Huberman, 1994). Such compromises are necessary and important in social science research, not only in maintaining the researcher's integrity but also to avoid damaging prospects of access for future research projects.

Chapter 3: The changing regulatory environment

It is estimated that if all the new rules that have been produced internationally to implement the G20's post-crisis regulatory framework were printed, there would be a 'pile of paperwork more than three Eiffel Towers tall' (Lee, 2015). Since the financial crisis, conduct of business and prudential regulation have been significantly reconfigured. Regulations also now increasingly prescribe how financial markets and those firms that operate within them should be structured (European Commission, 2014; Prudential Regulation Authority, 2015b) and require banks to have workable plans in place for an orderly resolution should they become insolvent (European Parliament and Council of the European Union, 2014a; Prudential Regulation Authority, 2014c).

A bank which is headquartered in the UK but operates in multiple countries with multiple lines of business (such as retail banking, investment banking and trading in the financial markets), will be subject to supervision[26] by many different regulatory authorities, each of which will have its own rules and expectations[27]. Following the crisis, the structures of the regulatory authorities responsible for creating and enforcing the regulations have been substantially reconfigured at a global, EU and national level. This chapter has two main aims. Firstly, it explains the empirical setting within which the research is situated, describing the changes to both regulations and the regulators which constitute the dynamic regulatory environment. Secondly, the chapter explains the technical complexities of prudential regulation which is important to grasp because this complexity adds to the challenges and uncertainties experienced by banks in the post-crisis situation. The chapter begins by explaining the rationale for prudential regulation and how this relates to banks and risk and how the prudential regulatory rules developed over time. The remainder of the chapter focuses on the post-crisis changes

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[26] A distinction is often drawn between *regulation* and *supervision*. The former refers to the 'establishment of specific rules of behavior' and the latter is 'the more general oversight of financial firms' behavior' (Goodhart, 1998, p. xvii). This thesis also follows this convention.

[27] The terminology of 'home' and 'host' supervisors is used to distinguish between the supervisor in the nation where the bank is headquartered and those supervisors in the countries where the bank has subsidiaries. Effective co-operation between home and host supervisors of cross-border banks is Principle 13 of the Basel Committee on Banking Supervision's Core Principles for Effective Banking Supervision (BCBS, 2012a)

to prudential regulations and its supervision within the UK from 2008 onwards, and describes this in relation to the changes which occurred at the EU and international levels. The chapter concludes with a summary of the key changes faced by banks in the UK.

What is prudential regulation?

Banks have generally been considered as fragile or even inherently unstable (Diamond & Dybvig, 1983; Minsky, 1977) which is related to the structure of their balance sheets. The maturity (or duration) of bank assets (e.g. loans) is longer than that of their liabilities (short term customer deposits) and through this process of maturity transformation banks play a valuable role in the economy. The risk is, however, that depositors will all wish to withdraw their cash on demand. The nature of fractional reserve banking compounds this risk, because banks have a relatively small proportion of assets in cash in relation to their total assets. If confidence in the bank diminishes, customers are more likely to simultaneously withdraw their deposits (Jacklin & Bhattacharya, 1988) and if this lack of confidence is widespread, it can cause a 'run on the bank' as with Northern Rock in 2007 (Baltensperger & Dermine, 1986; Diamond & Dybvig, 1983; Postlewaite & Vives, 1987). Banks may not have enough cash assets to honor their customer demands which could go on to cause a liquidity crisis, potentially leading to insolvency (Goodhart, Hartmann, Llewellyn, Rojas-Suarez, & Weisbrod, 2013; Llewellyn, 1999).

Banks play two additional roles in the financial system, which further contribute to systemic risk. Firstly, banks are providers of liquidity[28] to both financial markets and the wider economy. Second, they act as intermediaries in the payments system to ensure the transfer of funds for the settlement of mutual obligations (Goodhart et al., 2013) This interconnectedness, coupled with the asset to liability mismatch resulting from fractional reserve banking, means that the failure of one bank can be contagious, contributing to the fragility of the overall financial system as levels of trust and

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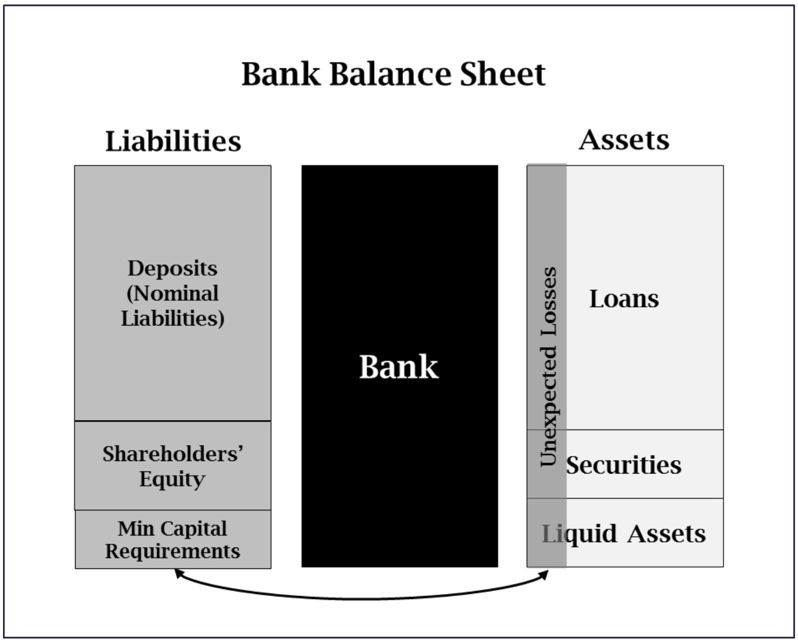
[28] Liquidity refers to the speed at which an asset can be sold in a market without a significant alteration to its price. Cash is the most liquid asset as it can easily and quickly be converted into other assets. The liquidity of a market is the extent to which assets can be bought and sold at stable prices. The provision of liquidity by banks refers to their ability to provide illiquid loans to customers whilst also allowing depositors access to funds on demand.

confidence in the banking system are reduced further. As witnessed with the 2007-8 financial crisis, the consequences of such systemic failure are not just confined to the financial markets but can have a significant negative impact on the wider economy (Brian & Patrick, 2010; Foster & Magdoff, 2009; Grusky et al., 2011; Stiglitz, 2010).

Prudential regulation aims to resolve or at least reduce the risk associated with the 'structural dilemma…[of] the asset-liability mismatch; the basic conflict between guaranteeing a return of capital (e.g. insurance claim, interest on deposits) whilst also putting that capital at risk' (Weber, 2010, p. 108). It does this by requiring that an appropriate portion of a bank's assets or investments are funded by money that has not been borrowed i.e. shareholder's equity. Because these funds do not have to be repaid at a particular time (instead, dividend payments are made based on profitability), increased amounts of equity enhance the loss absorbing capability of the bank[29]. The amount at which the minimum capital requirement is set depends on the levels of risk to which the bank is exposed (see Figure 3.1).

Figure 3.1 - Asset and liability structure of a typical bank



[29] It is important to understand that this does not imply that banks 'hold capital in reserve' as a store of funds that can be used to cover losses. As Admati and Hellwig (2014) argue capital is on the liability side of the balance sheet and cash reserves are on the asset side. Instead, the point of having minimum capital requirements is to prevent banks from taking on excess leverage (significantly more debt than equity funding) which can lead to insolvency.

Prudential regulation can also address the liability side of the balance sheet by ensuring that banks have adequate liquid assets (both in the short and long term) to service their liabilities. Historically, however, prudential regulation has tended to focus more on the asset side of the balance sheet (capital adequacy) rather than the liability side (liquidity). This changed after the financial crisis (see below).

Banks and risk

The 'identification, calculation, pricing and packaging of risk' is at the heart of today's financial markets (de Goede, 2004). It could even be argued that the management of risk is what constitutes the practice of banking itself. There are risks associated with both sides of the balance sheet. On the asset side are the risks related to loans and the trading of securities (equities[30], government and corporate bonds[31] and more complex products such as derivatives[32]) – credit risk, counterparty risk, market risk, and trading liquidity risk. The key risk connected with the liability side is liquidity risk. Banks also monitor and manage several non-financial risks which are also described below.

Credit risk is the risk that a borrower may not be able to repay a loan, i.e. the borrower goes into default. The management of credit risk has evolved since the 1990s from 'being based on gut feeling and experience to the use of statistical models, as technological and computing advancements enabled banks to adopt new, more scientifically based risk management systems' (Sappideen, 2004, p. 63). These statistical models monitor the creditworthiness of borrowers and typically assess the likelihood of the borrower defaulting, the amount of the loan exposure that would remain at the time of default, and the proportion of the loan that could be recovered in the event of a default.

When more complex products such as derivatives are considered, a specific type of risk needs to be measured. This is known as **counterparty risk** and is 'the risk that a counterparty in a derivatives transaction will default prior to the expiration of a trade

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[30] An equity is a share or stock issued by a company on a listed stock exchange

[31] A bond (either corporate or government) is a debt security which is issued in order to raise funds for the issuer, who in return pays a specified rate of interest over set period of time or 'tenor'.

[32] A derivative is a financial instrument whose value is dependent on an underlying market variable such as an equity price, an interest rate or a foreign exchange rate

and will not therefore make the current and future payments required by the contract' (Gregory, 2010, p. 16). Measurement of counterparty credit risk is performed using mathematical models that attempt to predict the value of the contract in the future and then calculate the associated potential risk exposure.

Derivative transactions and investments in other types of securities such as bonds and shares are also subject to **market risk**. This arises from the changes in the value of a market variable (or risk factor) such as an interest rate, an equity index or a foreign exchange rate. Changes in these risk factors will impact the prices of securities and derivative instruments that are held by banks. Again, these risks are managed and monitored using sophisticated mathematical models such as Value-At-Risk (VaR) that aim to predict the likely future movements in these market variables and the impact that that will have on prices.

Trading liquidity risk is concerned with whether a bank can sell an asset at short notice (to 'liquidate' it) and this in turn is dependent on whether there is a liquid market for that asset. When markets are illiquid, prices offered for an asset tend to be lower and thus larger losses are likely to be incurred by the seller but the buyer will get a bargain.

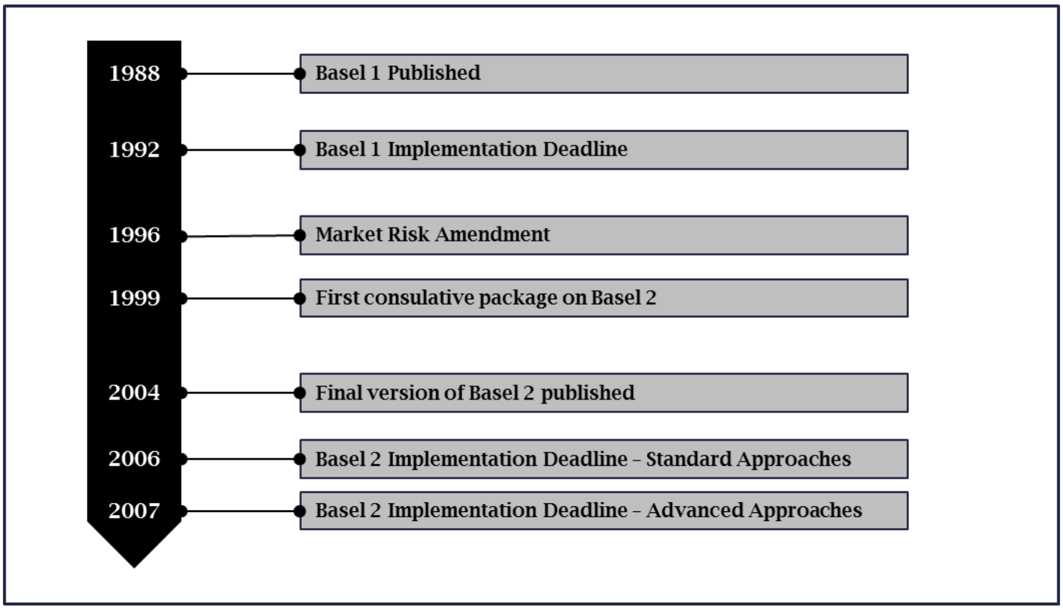
On the liability side, **funding liquidity risk** concerns the ability of a bank to meet cash obligations as they arise – such as the need to repay a deposit, pay interest on loans or pay for securities that have been purchased. Banks have several mechanisms available to raise funding liquidity when necessary, such as selling assets or borrowing money either from the wholesale market or the central bank. Each of these options has a cost involved such as the payment of interest, so in order to minimize funding costs, banks have to understand and monitor their future liabilities and assets to ensure the latter can cover the former.

The **other financial and non-financial risks** which banks manage include concentration risk (the risk of concentrating loans and other assets in one particular product type, industry sector or counterparty), interest rate risk (the risk associated with fluctuations in interest rates on loans), reputational risk (the risk of damage to the bank's reputation with customers, shareholders and investors resulting from its own conduct) and operational risk (the risk of losses associated with external events, including legal risk, and internal failures in systems, processes, and errors associated deliberate or accidental human conduct).

Prudential regulatory standards - the Basel Accords

Understanding the nature and level of risks to which banks are exposed is vital to determining levels of regulatory capital and is at the heart of prudential regulation. However, prior to 1988, there was no international regulatory consensus on how banks should prudently manage their balance sheets in light of these risks. In general, capital adequacy regulation was fairly simplistic and fragmented, with the typical requirement being for banks to hold a minimum capital ratio, calculated very simply as a ratio of capital to total assets (Tarullo, 2008). In the UK, this had only been a requirement since the Banking Act of 1987 (Rawlings, Georgosouli, & Russo, 2014, p. 14). There were no standards for taking the quantum of risk into account when calculating this ratio. Moreover, the constitution of capital, the size of the ratio and the stringency of enforcement varied by jurisdiction, giving rise to regulatory competition and an international playing field which was very much uneven (Davies & Green, 2008). Financial markets were becoming increasingly global and the types of financial products were growing in sophistication. Mounting concerns over the deteriorating levels of bank capital, the increasing levels of risk and the potential impact on the stability of the financial system led to the need for international convergence on capital adequacy standards and the creation of the first Basel Accord in 1988, known as Basel 1 (Davies & Green, 2008; Goodhart, 2011; Kerwer, 2005; Tarullo, 2008; Wood, 2005). As Figure 3.2 illustrates, the Basel Accord evolved over time, incorporating capital requirements for market risk in 1996 and then significant revisions between 1999 and 2004 resulting in Basel 2.

Figure 3.2 Evolution of the Basel Accords 1988 - 2007



The Basel Committee on Banking Supervision (BCBS) was formed by the nations of the G-10 in 1974 following the collapse of the German Bank Herstatt which created an international consensus that a transnational supervisory organization was required (Goodhart, 2011; Schenk, 2010; Tarullo, 2008; Wood, 2005). The BCBS is hosted by the Bank of International Settlements in Basel, Switzerland and states its mandate is to 'strengthen the regulation, supervision and practices of banks worldwide with the purpose of enhancing financial stability' (BCBS, 2013b, p. 1).

Discussions about Basel 1 began as early as 1981 and culminated in the release of the first Basel Accord in July 1988 which applied only to large, international banks. It was hoped that this new framework would:

> *'serve to strengthen the soundness and stability of the international banking system; and, secondly, that the framework should be fair and have a high degree of consistency in its application to banks in different countries with a view to diminishing an existing source of competitive inequality among international banks' (BCBS, 1988, p. 1).*

Simply put, this regime required banks to hold a minimum of 8% of capital[33] against their credit risk-weighted assets[34] only, calculated as

$$\frac{\textit{Capital}}{\textit{Risk Weighted Assets}} = 8\%$$

These standards defined the quality and composition of the capital numerator, along with how the denominator of Risk Weighted Assets (RWA) [35] needed to be calculated.[36]

This simple approach was not to last however, because 'the analysis of financial risk changed fundamentally in the 1990s for a number of reasons, not least perceptions about the potential for technology to support the applications of finance theory' (Power, 2007, p. 71). The growth of increasingly sophisticated methods for managing market risk within banks, such as VaR, led some financial institutions to challenge the existing regulatory requirements as being too conservative and not 'risk sensitive' enough, with the potential to damage the competitiveness of the market and dampen innovation. Of the risks outlined above, it is worth noting that Basel 1 was only concerned with credit risk assets and the risk of the default of borrowers[37].

The BCBS began its work on market risk in the late 1980s (Goodhart, 2011) at the same time as there were huge increases in the volume of derivatives trading (Anderson & McKay, 2008)[38]. This was accompanied by innovations in technology and mathematical modelling, such as VaR, allowing financial institutions to measure the downside risks of these investments as well as the potential for profit. Almost inevitably, these advances

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[33] It is interesting to note that the value of 8% was not based on objective calculations but was 'judged to be the kind of level that would allow well run banks to stay out of trouble most of the time' (Davies & Green, 2008, p. 38)

[34] Risk weighted assets refers to the measure of a bank's assets that has been adjusted to reflect the riskiness of that asset to the bank. The higher the risk weighting (e.g. 100%), the riskier the asset is considered to be.

[35] For a full listing of the risk weight categories, please see BCBS (1988) Annex 2

[36] The latter was a fairly straightforward approach of assigning risk weights to both on and off-balance sheet assets, based on the broad category to which the borrower belonged. These risk weights are 0% (cash and sovereigns), 20% (OECD banks), 50% (residential mortgages) and 100% (corporates, non-OECD banks)

[37] This was acknowledged by the Basel 1 Accord itself, which stated that '*the framework of measurement in this document is mainly directed towards assessing capital in relation to credit risk (the risk of counterparty failure) but other risks, notably interest rate risk and the investment risk on securities, need to be taken into account by supervisors in assessing capital adequacy. The [Basel] Committee is examining possible approaches in relation to these risks'* (BCBS, 1988, p. 1)

[38] For example, in its 1992 Annual Report, the Bank of International Settlements (BIS) showed an increase in the value of derivatives markets from $1.083bn in 1986 to $6.9bn in 1991 (Bank of International Settlements, 1992, p. 192).

also increased the need for tighter regulation around derivatives and the risks they posed to the financial system. The BCBS released the culmination of its work on the broadening of the existing Basel Accord to include market risk in a consultation paper in 1993 (Goodhart, 2011, p. 246). This proposal faced significant criticism from the industry largely based on the lack of sophistication in the proposed approach and the divergence from the risk management systems that were emerging in the market (Goodhart, 2011; Tarullo, 2008; Wood, 2005). As Tarullo notes, 'the large banks were essentially unanimous in urging the committee to permit the use of the so-called VaR models' (Tarullo, 2008, p. 63). The industry lobbying was eventually successful and the VaR approach was finally adopted by the BCBS in the 'Amendment to the capital accord to incorporate market risks' (BCBS, 1996).

The simplicity of the Basel 1 regulation was both its strength and its weakness. Basel 1 implementation was widespread across the BCBS member countries, largely because banks only had to perform straightforward calculations, requiring only minimal changes in existing regulatory reporting processes. The common approach across all banks also made the resulting capital ratios easily comparable and transparent. However, the dynamism of the financial environment caused BCBS to comment that:

> *'the financial world has developed and evolved significantly during the past ten years, to the point where a bank's capital ratio, calculated using the current Accord, may not always be a good indicator of its financial condition. The current risk weighting of assets results, at best, in a crude measure of economic risk, primarily because degrees of credit risk exposure are not sufficiently calibrated as to adequately differentiate between borrowers' differing default risks.' (BCBS, 1999, p. 9 para 6)*

The primary rationale for revising Basel 1 was to increase the risk sensitivity of the Accord, to remove the opportunities for regulatory arbitrage[39] and to support the calculation of the minimum capital requirements with stronger supervision and enhanced market discipline (Benink, Danielsson, & Jónsson, 2008; Danielsson, 2003; Danielsson et al., 2001; Tarullo, 2008). The negotiations for the revised Accord were long, protracted and arduous, but Basel 2 was finally published in July 2004, after some

[39] Regulatory arbitrage occurs when banks exploit loopholes in regulatory standards to avoid certain types of regulation.

eight years of development, three substantial consultation papers and three quantitative impact studies (Tarullo, 2008; Wood, 2005). It represented a step change in terms of sophistication (and complexity) from the previous Accord and aimed to develop

> *'a framework that would further strengthen the soundness and stability of the international banking system while maintaining sufficient consistency that capital adequacy regulation will not be a significant source of competitive inequality among internationally active banks' (BCBS, 2004, p. 2 para 4).*

Basel 2 consisted of three 'pillars'. Pillar 1 concerned the setting of the minimum capital requirements and prescribed the risk calculation methodologies that banks were permitted to use in determining their capital requirements. It provided a menu of increasingly sophisticated measurement methods, and the expectation was that the largest, internationally active banks would implement the most advanced methods.

Pillar 2 focused on the requirements for the national supervisors. Their role was to ensure that banks under their supervision held enough capital for the risks they faced and national supervisors had the discretion to increase the capital requirements should they deem this necessary. In parallel, Pillar 2 also outlined the processes banks needed to assess their own capital adequacy vis-à-vis their risk profile, such as stress testing[40].

The third Pillar outlined the requirements for the public disclosure of capital and risk information, in the hope that this would garner greater discipline in risk management processes. On an annual basis banks had to disclose detailed qualitative and quantitative information on aspects of the Basel 2 standards. Such disclosures had never been required before and represented an increase in the amount of capital and risk data that banks had to produce, manage and report.

Pillar 1, in particular, transformed the way that banks had to calculate their capital requirements. For Credit Risk, the approaches ranged from the simple Standardized

[40] Stress testing is a type of scenario analysis whereby banks subject their current portfolio to market conditions under stress to try to understand what happens to the associated risk and therefore capital requirements. Different scenarios can be used based on different economic variables.

Approach (STD)[41] to the more complex, Internal Ratings Based (IRB) approaches[42]. The IRB approaches followed the precedent set by the 1996 Market Risk Amendment in allowing banks to use their own internal models for the assessment of credit risk parameters which are then used as inputs into the supervisory defined RWA and capital calculation. To qualify for the IRB approaches, banks had to be able to demonstrate the soundness of their internal models, the availability of the requisite amount of historical data and meet other stringent requirements for their risk management systems and processes.

As Figure 3.3 shows, there was no change at this time to the requirements for Market Risk. However, a new category of risk management was introduced, that of Operational Risk. This is defined as 'the risk of loss resulting from inadequate or failed internal processes, people and systems or from external events. This definition includes legal risk, but excludes strategic and reputational risk' (BCBS, 2006b, p. 144 para 644) and has posed banks with significant challenges in terms of applying some of the statistical approaches for the measurement of credit and market risk to an altogether broader type of risk and one with a less established practice of management (Power, 2005a, 2007).

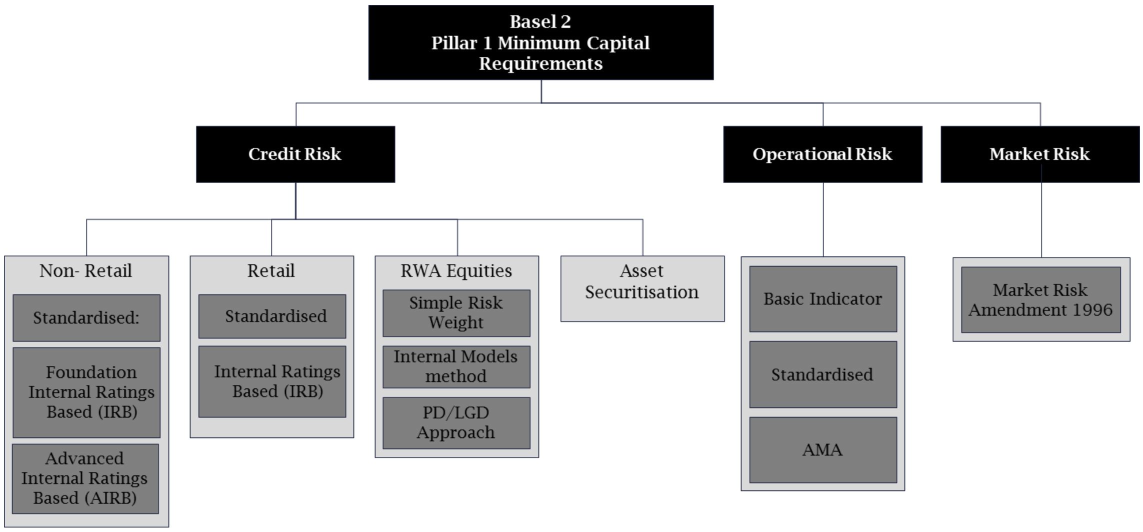
Basel 2 was not without its critics, who drew attention to two specific shortcomings – the reliance on banks' statistical risk models in the setting of minimum capital standards and the inherent pro-cyclicality of the rules which posed a risk to the whole financial system (Benink et al., 2008; Danielsson, 2003; Danielsson et al., 2001). The advanced credit risk models under Basel 2 assume that the behavior of market participants has no impact on the outcomes predicted by the risk models. However, as Danielsson et al. (2001) explain 'by encouraging all market participants to employ similar risk modelling techniques regulation renders them more homogenous in risk-aversion and trading strategies, thus rendering the financial system less stable' (Danielsson et al., 2001, p. 7).

[41] The Standardised Approach is similar to Basel 1 in that it categorizes credit exposures by the nature of the borrower, but is much more granular and risk weights are derived from a mapping to external credit ratings.

[42] There are two Internal Ratings Based Approaches – Foundation and Advanced (FIRB and AIRB). The Foundation approach allows banks to use own estimates of Probability of Default only, whereas the advanced approach allows own estimates of Loss Given Default, Exposure at Default and maturity also.

The problem of pro-cyclicality is related to the economic business cycle of 'boom and bust'. In the good times, banks will expand their lending activities and contribute to economic growth. As economic conditions worsen, however, banks will suffer higher defaults on loans, and will potentially scale down lending activity in response. The argument is that Basel 2 could amplify these effects and worsen the economic conditions in a downturn (Allen & Saunders, 2004). Notwithstanding these criticisms, the implementation of Basel 2 went ahead with the release of the final version of the accord in 2004 (BCBS, 2004).

Figure 3.3 - Decomposition of Basel 2, Pillar 1



Even though Basel 2 applied to large internationally active banks, the Accord itself did not have the status of law (Brummer, 2015; Kerwer, 2005). In order for these international standards to be legally enforceable by banking supervisors, they had to be enacted in law in national jurisdictions. As a European Union member state, the applicable legislation for the UK was the Capital Requirements Directive (European Parliament and Council of the European Union, 2006) which was then adapted into UK law as the Prudential Standards section of the Financial Services Authority Handbook (the FSA's compendium of regulatory rules). The Financial Services Authority (FSA), as the UK financial regulator, was also responsible for monitoring UK banks' implementation and compliance with these rules. To use the advanced risk modelling approaches under Pillar 1, banks had to apply to the FSA for a 'waiver'[43]. The initial approval of these waivers often had conditions attached both pre-implementation and on an ongoing basis and indeed, for the IRB waivers, all approvals that were issued were subject to conditions (FSA, 2011a, p. 336 para 843). The FSA also had to conduct its supervisory responsibilities in accordance with Pillar 2 and, in addition to the Pillar 3 disclosure requirements, the FSA required the reporting of capital and risk information on a regular basis, consisting of nine reporting templates containing some 2,000 individual items of data in total (FSA, 2006).

The move from Basel 1 to Basel 2 required banks in the UK to make significant changes to achieve compliance with the new rules. Implementing the advanced risk models involved the design of new mathematical risk methodologies and the collection of large amounts of historical transaction data (James & Ong, 2004). The new rules also necessitated major changes to information technology systems, systems and processes for the collection and aggregation of risk data, business processes and procedures, risk management policies and even governance and organizational structures (Wilson, 2004). It is estimated that the incremental cost of compliance with Basel 2 for the UK financial services industry was £1.1 billion (PriceWaterhouseCoopers, 2005).

The BCBS's aim was for Basel 2 to be implemented by the end of 2007 for the most advanced approaches, and sooner for the simpler ones. This ambition, however, was thwarted not only because of a global divergence in adoption timetables[44] but more importantly, the advent of the global crisis in 2007-8, raised serious questions regarding the efficacy of the Basel 2 regime and heralded a further wave of regulatory reform, as the next section will describe.

[43] Waivers are granted under Section 148 of the Financial Services and Markets Act 2000. There were three types of waiver available – one for credit risk (to use the IRB approach), one for counterparty credit risk (to use the Internal Models Method [IMM] approach) and one for market risk, (to use VaR for calculating market risk).

[44] The 2013 implementation survey by the BCBS shows that three of its 27 member were yet to complete Basel 2 implementation, five years after the target date (BCBS, 2013e).

Global and European regulatory reform

2007 witnessed the beginning of the global financial crisis, triggered initially by fears about defaults on mortgage lending following the 'housing bubble' in the US. These fears spread to the UK, which experienced the first run on a bank – Northern Rock – in over one hundred years. As market liquidity and confidence dried up, there were a number of near or actual collapses of financial institutions in the UK, the USA and continental Europe. Governments stepped in to inject money into failing banks and central banks pumped liquidity into the financial system. The crisis was followed by the 'Great Recession', the worst global recession since World War 2, according to the IMF (International Monetary Fund, 2009).

Amongst many other causes, regulatory failure has been cited as a key contributing factor to the global financial crisis (Financial Services Authority, 2009e; Financial Stability Board, 2009b, 2009c; Financial Stability Forum, 2008; Larosière, 2009; London School of Economics, 2010), precipitating an unprecedented level of regulatory reform (Black, 2010a; Ferran, 2012a; Ferran et al., 2012; Goodhart, 2009; Helleiner et al., 2010; MacNeil, 2010). Most fundamentally, this regulatory failure was a failure of the intellectual footing which underpinned the structures and mechanisms of international financial regulation (Baker, 2013; Black, 2012b; Financial Services Authority, 2009e). Prior to the crisis, regulators, policy-makers, politicians and the financial industry had shared beliefs about the efficiency of the markets and their capacity for self-correction. In addition, the crisis revealed the flawed assumptions regarding the way the financial system worked – that risks were efficiently diversified, largely through financial innovation and that the risk of the system of the whole was best understood as an aggregate of the risks of individual financial firms (Baker, 2013; Black, 2012b). Instead, the crisis demonstrated the significant interconnectedness of the financial system, likened by Haldane to a complex ecosystem (Haldane & May, 2011) which was much more fragile than the previous orthodoxy had suggested.

Resolving the problems of the crisis and preventing a future financial collapse of this scale were the clear priorities of policy-makers in the aftermath of 2007 – 8. These solutions required significant cognitive or ideational shifts (Baker, 2013; Black, 2012b) away from the crumbling intellectual edifice of the efficient markets hypothesis towards other ideas about how to preserve the stability of the financial system, and about how much regulatory authorities should intervene in the financial industry. The championing of 'macro-prudential' regulation by the BCBS (Caruana, 2009), the Bank of England (Bank of England, 2009) and the G20 (G20, 2009) is one such example of these shifts.

Macro-prudential regulation is targeted at maintaining the stability of the financial system as a whole, as opposed to the micro-prudential approach which focuses on the risks of individual firms failing. Whilst macro-prudential ideas were not new (Baker, 2013; Clement, 2010; Galati & Moessner, 2013) they had been marginalized in favor of the micro-prudential regulation of the first two Basel Accords. Elements of the macro-prudential policies were therefore incorporated into the regulatory reform packages at both an international and an EU level (see below).

Approaches to regulatory supervision were also revisited as a result of these ideational shifts. Because macro-prudential regulation views risk as both 'endemic and endogenous to the financial system' (Baker, 2013, p. 118), there were stronger arguments for increased state intervention in the financial industry to better understand and manage these risks. As the discussion below on the changes to the UK prudential regulatory regime illustrates, this led to the adoption of more intrusive styles of banking supervision, and more globally, an understanding that the level of surveillance of the financial system needed to increase (Black, 2012b).

This section explains the nature of the post-crisis reforms at both a global and EU level. Whilst the empirical context for this study is the regulatory change experienced by banks in the UK, to fully understand the dynamics of the regulatory environment for UK banks, it is necessary to put these in the context of the changes that have occurred at a global and European level. Not only do banks in the UK operate internationally, but the regulatory changes at an international level also form part of the UK context within which the UK regulators operate.

Basel 3 and the fourth Capital Requirements Directive (CRD 4)

In November 2008, the G20 summit in Washington produced an Action Plan detailing how the issues of the global financial crisis were going to be addressed. This plan laid out five key principles for reform, including 'Enhancing Sound Regulation' through which the G20 countries declared 'we pledge to strengthen our regulatory regimes, prudential oversight, and risk management' (G20, 2008, p. 3). This commitment broke down into several both immediate and medium term activities pertinent to prudential regulation. These are clearly articulated in the subsequent 'G20 Declaration on Strengthening the Financial System' and summarized below:

- Post recovery, strengthen prudential regulatory standards in terms of quantity and quality of regulatory capital, with a harmonized definition of what counts as regulatory capital.
- Measures to mitigate pro-cyclicality[45]
- Creation of a non-risk based measure of leverage[46]
- Improving the framework for risk management of securitization[47]
- Development of framework to promote stronger liquidity buffers
- Development of enhanced guidance to strengthen risk management practices
- Ensure capital requirements for counterparty credit risk (related to derivatives products) are adequate and enhance them where necessary (G20 2009)

The Basel Committee on Banking Supervision was charged with developing standards around these elements which crystallized into two consultative papers released by the BCBS in December 2009 (BCBS, 2009c, 2009d). These papers built on the existing Basel 2 framework by firstly strengthening the rules relating to securitization, which was implemented at the end of 2010 (BCBS, 2009a). The second set of amendments,

[45] Pro-cyclicality refers to the fact that the riskiness of assets varies over the business cycle and that the Basel 2 regulations exacerbate this.

[46] Leverage is the ratio of debt to equity (or assets to liabilities) of a company

[47] Securitization is the process whereby assets, such as mortgages, are pooled and carved up and sold to different types of investors with different rates of interest depending on the riskiness of that security. The need to strengthen the prudential rules for securitization arose from the growth, complexity and opacity in this market. The risks of complex structures such as collateralized debt obligations (CDOs) were not fully understood and inadequately capitalized. These structures were also implicated in the sub-prime mortgage crisis. See Tett (2009) and Stiglitz (2010).

implemented at the end of 2011, enhanced the market risk framework to better capture the full range of risks associated with capital markets 'traded' products such as derivatives, bonds and equities, particularly under conditions of stress (BCBS, 2009b). These two papers together became known colloquially as Basel 2.5. The major overhaul of the Basel 2 Accord was achieved through the publication of the Basel 3 rules in 2011 (BCBS, 2011).

This comprehensive framework made changes to the micro-prudential rules in terms of the quality and quantity of regulatory capital, enhancements to risk coverage and risk management, particularly for derivative instruments. Macro-prudential measures such as a non-risk based leverage ratio measure and requirements for counter-cyclical capital buffers were also introduced. Liquidity risk was also incorporated into global prudential regulation for the first time in the form of short and long term liquidity measures and associated reporting and monitoring requirements (BCBS, 2011). Implementation of these new measures was on a phased basis, beginning in 2013 with the enhanced risk coverage and risk management elements and then a transition period for the leverage ratio, capital buffers and liquidity risk until 2019. Additional final rules relating to the leverage ratio (BCBS, 2014a) and the new rules for liquidity (BCBS, 2013a, 2014b) were produced after the initial publication of Basel 3. At the time of writing (2016), the BCBS has released final versions of all the standards that comprise Basel 3.

In addition, at the time the fieldwork was conducted, the BCBS released three consultation papers regarding further reform of the market risk element of the Basel Accord (BCBS, 2012b, 2013c, 2014c). It had been signaling this for some time under the moniker 'The Fundamental Review of the Trading Book'. This proposed an overhaul of the market risk framework by introducing a replacement for VaR for the calculation of capital requirements for market risk, and final rules were released in 2016 with the framework coming into effect on 1st January 2019 (BCBS, 2016).

To reiterate the point made above, the standards set by the BCBS do not have the status of legal enforceability within national jurisdictions and therefore have to be translated into legislation in order for them to be binding on banks and financial institutions. For those banks based in the EU (including those in the UK), the BCBS standards are enacted through EU law, which must go through the full European legislative process. In terms of the changes to Basel 2 outlined above, the first set were incorporated into Directive 2009/111/EC (known as Capital Requirements Directive [CRD] 2) and the Basel 2.5 market risk changes became EU Directive/2010/76/EU, known as Capital Requirements Directive 3 and both were in legal force throughout the EU member states from November 2010 with a final implementation date of December 2011.

Within the EU, legislation either takes the form of a *Regulation* or a *Directive*. An EU Directive allows for EU Member States to interpret and adjust the legal text to the national context whereas an EU Regulation requires that all Member States adopt the regulation as is, with no opportunity for the use of national discretion. For Basel 3, some elements of Basel 3 were enacted as a Directive, but the majority of the rules that relate to capital adequacy and liquidity were enacted as a Regulation. The EU is taking the opportunity to harmonize the prudential regulations across all member states to create a single rule book for all Member States. This package is known as CRD 4 and was approved by the European Parliament on 16 April 2013 (European Parliament, 2013) and passed into law in July 2013 (European Parliament and Council of the European Union, 2013). However, the negotiation of CRR/CRD 4 experienced delays due to extensive negotiations amongst the nation states (Ferran, 2012a). The Directive included rules for bankers' remuneration which proved to be a particular bone of contention between the UK and other EU Members (Barker, 2013a, 2013b). As a result, the original planned implementation date of 1 January 2013 for some elements of the rules was postponed until 1 January 2014, with the rest of the implementation timetable mirroring that of Basel 3.

In addition to the primary legislative text, in line with the EU's legislative process[48], by 2016, the European Banking Authority (EBA) had drafted three quarters of the required

[48] The European Union Legislative process for the development of regulation in the European Union is known as the Lamfalussy process and comprises four levels, each of which focus on a different stage of the regulatory implementation process. Level 1 refers to the development of a Directive or Regulation. Level 2 is level at which Regulatory Technical Standards (RTS) and Implementing Technical Standards (ITS) are produced by the relevant European regulatory body. RTS and ITS differ in terms of how they are adopted by the European

additional technical standards for CRR / CRD 4 (European Banking Authority, 2016) which give further details and guidance to banks and national supervisors. This is of relevance here because even through the high-level rules had been agreed and published, these more detailed guidance standards also had to be incorporated into banks' compliance plans. Finally and further to the release of the BCBS final rules on the leverage ratio and liquidity risk, the EU passed two additional delegated acts to enshrine these final rules in EU law (European Commission, 2015a, 2015b).

Figure 3.4 summarizes the global, EU and UK development of prudential regulatory standards and their implementation dates and shows the data collection timelines for both the discourse analysis work and interview fieldwork carried out for this study. The timeframe for the discourse analysis spanned not only the final implementation of Basel 2 but also all the changes that culminated in Basel 3. By the time the interview fieldwork was conducted in 2013-14, most of the Basel 3 and CRD4/CRR rules had been formally agreed and some rules were already in force.

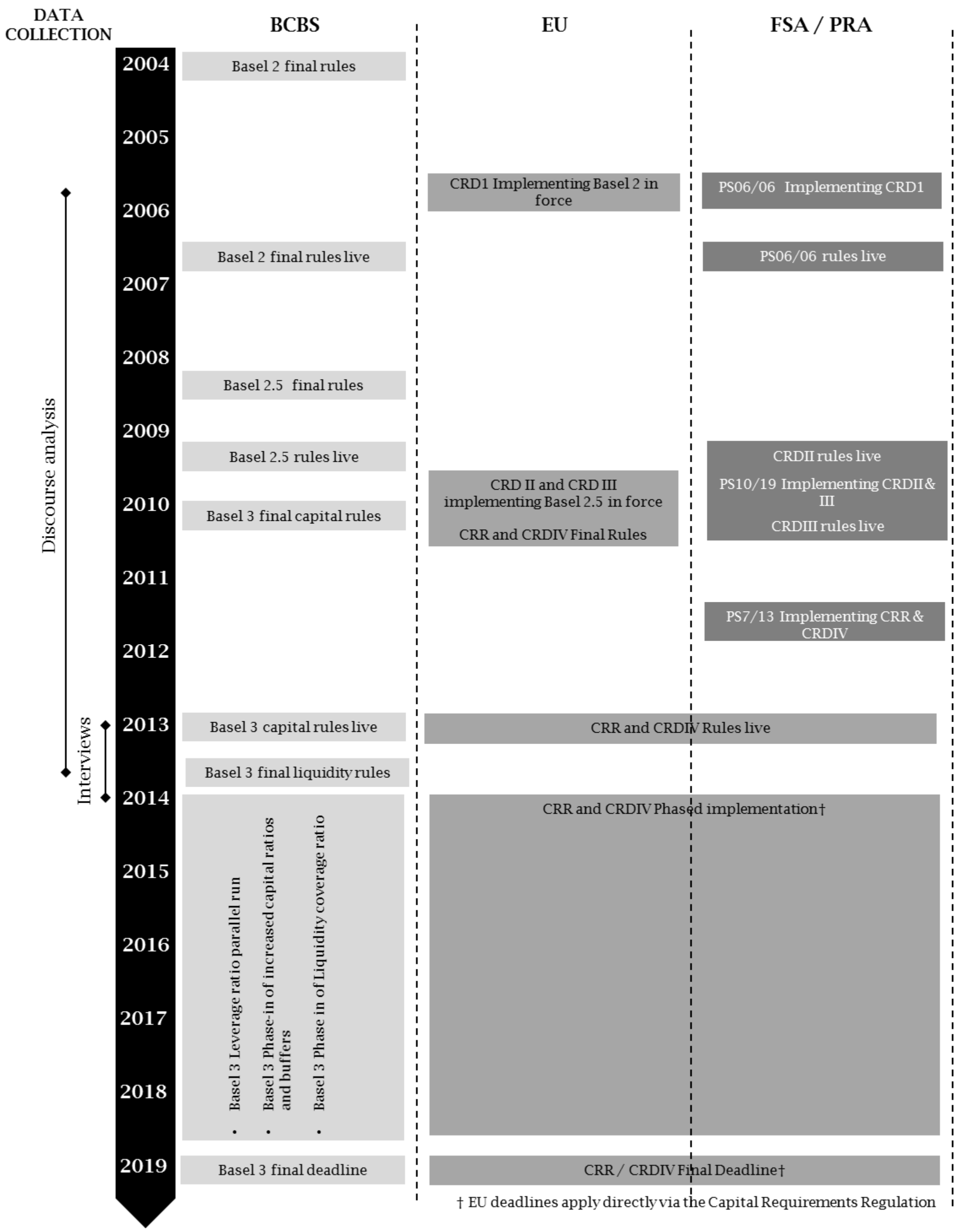
Changes to global and EU regulatory authorities

At an international level there is a balance to be struck between enabling the global co-ordination and oversight of the global financial industry and compromising national sovereignty (Davies & Green, 2008). International organizations such as the BCBS act as global standard setters but do not have enforcement powers or responsibility for the day-to-day supervision of banks, both of which fall to national regulatory authorities. Within the European Union, the situation is slightly different given that laws are set at an EU-wide level but again, at least prior to 2008, supervision and enforcement were performed by 'national competent authorities' (bank supervisors in the EU Member States). The financial crisis revealed the inadequacies of the regulatory architecture as both an international and EU level (Financial Services Authority, 2009e; G20, 2009; Larosière, 2009; London School of Economics, 2010) and the subsequent reforms have focused on strengthening the powers of the regulatory bodies and improving co-

Commission. RTS are adopted through a Delegated Act which is a non-legislative act used to supplement or amend elements of an existing legislative act. Implementing Acts, though which ITS are adopted, are used when there is a need for uniform conditions for implementation in EU Member States.

operation and co-ordination between them (Black, 2012b; Ferran et al., 2012; Helleiner et al., 2010).

Figure 3.4 Development of prudential regulation 2004 - 2019



The global financial crisis highlighted that the truly international and systemic nature of the global financial market had not been adequately recognized in the regulation and supervision of significant cross-border financial firms (G20, 2008; Larosière, 2009; Turner, 2009). To ensure better information sharing and to gather a more holistic picture of the risk of these firms to global financial stability, both the G20 and the EU favoured the development and implementation of 'supervisory colleges' for the most significant cross-border firms. Supervisory colleges are 'multilateral working groups of relevant supervisors that are formed for the collective purpose of enhancing effective consolidated supervision of an international banking group on an ongoing basis' (BCBS, 2010d). The Financial Stability Board (FSB) reported in 2012 that core supervisory colleges had been established for 29 of the most globally significant banks (Financial Stability Board, 2012a, 2012b).

Strengthening the powers of some of the key regulatory bodies in place at both a regional and global level was necessitated by the increased focus on systemic financial stability and macro-prudential regulation. There was also a recognition that the authority of the existing bodies responsible for overseeing the implementation of regulatory standards needed to be bolstered (Arner & Taylor, 2009; Black, 2012b; Helleiner, 2010). On an international scale, the Financial Stability Forum[49] was renamed to the Financial Stability Board (FSB) and given a mandate by the G20 to 'to coordinate at the international level the work of national financial authorities and international standard setting bodies (SSBs) in order to develop and promote the implementation of effective regulatory, supervisory and other financial sector policies' (Financial Stability Board, 2009a).

Similarly, within Europe, the need for macro-prudential regulation was highlighted by the Larosière report (Larosière, 2009) which recommended the creation of the European Systemic Risk Board (ESRB) under the auspices of the European Central Bank. The ESRB was formally established in December 2010 with responsibility for

[49] The Financial Stability Forum was founded in 1999 by G7 Finance Ministers and Central Bank governors to promote international financial stability. See Davies and Green (2008, pp. 113-118).

'the macro-prudential oversight of the financial system within the Union in order to contribute to the prevention or mitigation of systemic risks to financial stability in the Union that arise from developments within the financial system and taking into account macroeconomic developments, so as to avoid periods of widespread financial distress.' (Union, 2010).

Further institutional reform in the EU followed with the creation of the European System of Financial Supervision (Ferran, 2012a, 2012b; Moloney, 2010, 2012). This comprised the ESRB, plus three additional European Supervisory Authorities (ESAs). These ESAs effectively replaced the extant European bodies that advised the European Commission on the detailed technical regulatory rules underpinning the high-level principles set at Commission level. The Committee of European Banking Supervisors (CEBS) became the European Banking Authority (EBA) which had oversight for banks in the EU. The Committee of European Securities Regulators (CESR) was succeeded by the European Securities and Markets Authority ESMA) and the European Insurance and Occupational Pensions Authority replaced the Committee for European Insurance and Pensions Supervisors (CEIOPS) (Ferran, 2012b). The ESAs were established as legal personalities by the end of 2010 and are part of a network of authorities, along with national supervisors and the ESRB that will 'ensure that rules are applied in a rigorous and consistent fashion throughout the European Union, to monitor developments within the financial system as well as to detect potential risks to financial stability' (European Commission, 2011c).

In 2014, the European Central Bank (ECB) became responsible for the prudential supervision of banks in the euro area as part of the EU's Single Supervisory Mechanism (SSM). This is a framework for banking supervision in Europe and comprises the ECB and the national competent authorities of the participating countries (European Central Bank, 2014a, 2014b). The UK falls outside the SSM but subsidiaries of UK banks operating in euro area countries are subject to the SSM.

Changes to the regulatory architecture at both an international and EU level are important to understand because they show the increase in supervisory powers. In the case of Europe, there was a blurring of the responsibilities between the regulatory tasks of the EU authorities and the UK regulators, the FCA and the PRA, contributing further to the uncertainty of the regulatory environment of UK banks.

Regulatory change in the United Kingdom

Prior to the financial crisis, the importance of the financial sector to the UK economy was rarely called into question (Bell & Hindmoor, 2015; Engelen et al., 2012; Johal, Moran, & Williams, 2014). Politicians of all colours made statements of support for the UK banking industry (Furness, 2012), exemplified by the then Economic Secretary Ed Balls who asked of his City audience, 'what more can I do – can we do together – to support and enhance the critical role that the banking industry plays in our economy?' (Balls, 2006). The City of London was valued because of its position as a competitive international financial centre, its contribution to Gross Domestic Product (GDP) and tax revenues and the number of people it employs (Darling, 2011; Norfield, 2016). As an industry, banking was viewed as playing a critical part in society, providing finance (credit) to households and the public and private sectors.

As Engelen et al. (2012) outline, this view of the social value of banking was further bolstered by widely held beliefs about the stability and efficiency of the financial markets. Economic and financial theories, such as the efficient market hypothesis led politicians, economists, regulators and industry actors to share a belief in the discipline of the market. Because the financial markets were thought to diversify risk effectively through innovative financial instruments such as derivatives and securitization, there was seen to be no need for intrusive or interventionist regulation. Thus, a consensus about the necessity of 'light-touch' regulation was held amongst the policy elite and became the cornerstone of the UK bank regulatory regime in the late 1990s and early 2000s.

As the events of the financial crisis unfolded, the flaws in the assumptions underpinning the light-touch regulatory philosophy were exposed. For politicians, this meant intervening in the market and part re-nationalizing banks such as RBS and Lloyds (HBOS) to prevent them from collapsing into insolvency. Such actions were antithetical to the neoliberal ideology of the free market but, as Darling (2011) argues in his memoir 'the risk of one bank collapsing and taking all the others with it was acute…I would not have wanted to be responsible for the economic and social catastrophe that might follow' (Darling, 2011, p. 142).

Moreover, politicians asked existential questions about the role of banks in society and the ability of these organizations to discipline themselves (Darling, 2009; HM Treasury, 2009; House of Commons Treasury Committee, 2008) and so did regulators (Financial Services Authority, 2009e) the banks themselves (Bischoff & Darling, 2009) and also the public at large (Bennett & Kottasz, 2012; Edelman, 2009, 2010; Heath et al., 2010; Ipsos Public Affairs, 2012). The legitimacy of the banking industry was damaged and the increasing political salience of regulatory reform meant that banking regulation was no longer a matter of 'quiet politics' (Culpepper, 2010).

Rather than being discussed behind the closed doors of the City, regulation was now in the 'glare of a highly politicized arena involving aggressive new actors in government and the regulatory sphere armed with new ideas that are far more sceptical and critical of the City than was the case prior to the crisis' (Bell & Hindmoor, 2015, p. 458). The previous narrative hegemony of the benefits of financial innovation and market self-discipline was undermined and with it, the power of finance in the UK was destabilized (Bell & Hindmoor, 2014, 2015; Johal et al., 2014; Moran & Payne, 2014). In this environment, the previous orthodoxy of non-intrusive regulation was revisited and both politicians and regulators called for more adversarial bank supervision and more effective enforcement of regulatory rules (HM Treasury, 2009; Sants, 2009).

This section discusses the regulatory changes that came about in the UK, reflecting not only these shifts in how regulation was viewed in the UK but also the changes that were happening on a global and EU level. Two distinct stages of regulatory reform can be identified – those that occurred in the immediate aftermath of the crisis (between 2008 and 2010) and those from 2010 onwards. This division corresponds to the change in the UK Government following the 2010 general election, when a coalition government comprising the Conservative and Liberal Democrat parties replaced the previous Labour government. It is worth noting that most of the changes across these periods had been accomplished prior to the interview fieldwork and therefore banks were in the process of responding and adapting to these changes.

Regulatory reform 2008 – 2010

In the immediate aftermath of the crisis and prior to the research period, when the Labour Government, led by Gordon Brown was still in power, changes at a national level echoed those that were taking place regionally and internationally. The focus was on improving oversight and giving the existing regulatory bodies additional powers. The Council for Financial Stability was created, comprising the Treasury, the Bank of England and the Financial Services Authority. The remit of this Council was 'to analyze and examine emerging risks to the financial stability of the UK's economy and co-ordinate the appropriate responses' (HM Treasury, 2009, p. 47).

The Bank of England's objectives for financial stability were made statutory in the Banking Act 2009 which also established a Financial Stability Committee under the auspices of the Bank of England to support the achievement of this objective. Similarly, the FSA was to be given a statutory objective for financial stability. The intention was to further strengthen the FSA's enforcement and information-gathering powers (HM Treasury, 2009, p. 60). Thus, there were to be no changes in the existing tripartite structure (HM Treasury, Bank of England and the FSA), just a greater focus on financial stability and some enhancement of existing powers.

In terms of the shifts in supervisory approach, it is worth looking retrospectively at the assumptions and rhetoric that surrounded the FSA's style of supervision prior to the failure of Northern Rock in 2007. The FSA has been characterized as a 'light touch' regulator, with an underlying philosophy based on two key assumptions - that the senior management of financial organizations can be trusted to do the 'right thing' and that financial markets are inherently stable (FSA, 2000, 2007; Larosière, 2009; Turner, 2009). This, combined with a political desire to retain London's competitiveness as a global financial centre and not to overburden businesses with 'red tape', led to a style of risk-based, outcome-focused, principles-based regulation. This is summed up by this extract of a speech made by Gordon Brown in 2005:

> *'In a risk based-approach there is no inspection without justification, no form filling without justification, and no information requirements without justification. Not just a light touch but a limited touch. Instead of routine regulation attempting to cover all, we adopt a risk-based approach which targets only the necessary few.' (HM Treasury, 2005)*

Risk-based regulation meant that regulatory resources were allocated to those institutions considered to be at the highest risk to the FSA's statutory objectives. The regulatory standards with which banks were meant to comply were couched as broad principles, with the emphasis on senior management to adhere to these principles without prescribing how - this was at the discretion of senior management. However, the failure of Northern Rock in 2007 and RBS in 2008 called into question the effectiveness of this style of regulation. The FSA's internal audit report on the failure of Northern Rock highlighted several flaws in the FSA's supervisory approach (FSA Internal Audit Division, 2008), stating that the FSA's 'overall regulatory philosophy as a risk-based, outcomes-focused regulator is supported and reinforced by this analysis…[but] there are clearly a number of management, operational and cultural improvements that should be made to the overall supervisory process' (FSA Internal Audit Division, 2008).

These improvements comprised the FSA's Supervisory Enhancement Programme (SEP), put in place in 2008. The key elements of this programme were summed up in the FSA's new philosophy of 'intensive supervision' (Sants, 2009) and included:

- Increased supervisory resources in terms of both quality and quantity
- Minimum levels of supervisory staff allocated to high impact firms
- Strengthening and expansion of the prudential risk department
- Increased involvement of senior FSA management in the supervisory process
- Introduction of business model risk and financial stability into the risk assessment framework
- Greater emphasis on assessing the competence of firms' senior management
- More focus on liquidity (FSA, 2008)

During this period, the FSA was also responsible for overseeing the UK implementation of the interim changes to Basel 2 (see Figure 3.4) and issued several consultation papers

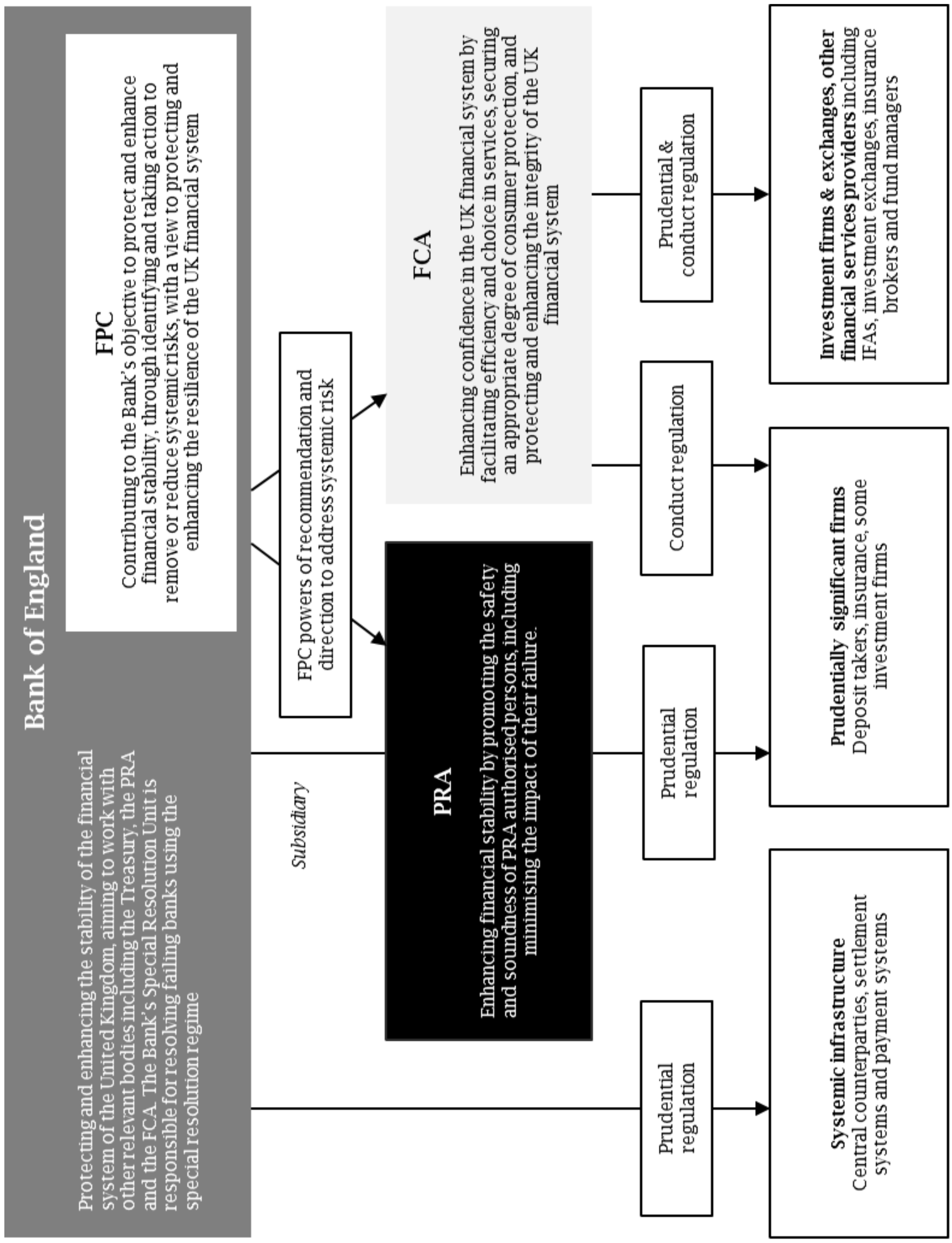
(Financial Services Authority, 2009a, 2009b, 2009c, 2010a). Legal instruments were passed in 2010 to implement the CRD 2 changes (FSA, 2010b) and in 2011 for CRD 3 (FSA, 2011b).

Regulatory reform 2010 onwards

When the coalition government came into power, the new Chancellor of the Exchequer, in a speech made at Mansion House in June 2010, signalled a complete overhaul of the existing UK regulatory structure (Osborne, 2010). This was to consist of the abolition of the FSA, the creation of a new Prudential Regulation Authority as a subsidiary of the Bank of England, the creation of an independent Financial Policy Committee at the Bank of England to manage macro-prudential matters and the creation of a third organization, to be a consumer protection and markets authority, subsequently named the Financial Conduct Authority (HM Treasury, 2011). Thus, the regulatory architecture was to move from the single, integrated regulator (the FSA) to a so-called ‘twin peaks’ structure (the PRA and the FCA). The timetable for this restructure was rapid, and was completed on 1 April 2013.

The roles and responsibilities of these three new regulatory bodies were clearly defined in consultation papers and in the draft legislation of the Financial Services Bill, given Royal Assent on 19 December 2012. The Financial Policy Committee’s key objective is to support the Bank of England’s statutory objective to ‘protect and enhance the stability of the financial system of the United Kingdom’ (HM Treasury, 2010, p. 12). The FCA is an independent body, with a remit to protect and enhance confidence in the UK’s financial system. Finally, the PRA’s objective is to promote the safety and soundness of regulated financial organizations. It is worth noting that the PRA was formed by the transfer of 1,100 staff to the Bank of England (FSA, 2012a, p. 19), and is a subsidiary of the Bank of England. The diagram in Figure 3.5 shows the new regulatory architecture and the relationship between the various bodies.

Figure 3.5 The New UK Regulatory Architecture



Source: HM Treasury

From the 1st April 2013, most large UK banks had to interact with two regulators, each with a different set of objectives. In an attempt to make this transition smoother, the FSA was internally re-organized and the Risk and Supervision Business Units were replaced by the Conduct Business Unit and the Prudential Business Unit. In April 2012, further progress was made with this split into two business units, with the creation of 'two separate but coordinated supervisors for banks, insurers and major investment firms covering prudential and conduct' (FSA, 2012a, p. 14). This process completed on 1st April 2013 with the legal cutover to the FCA and PRA. By the time the fieldwork interviews were conducted, the new regulatory authorities were in place and banks were subject to supervision by the PRA.

Not only did the coalition government substantially re-organize the structures of the UK regulatory environment, the plans for the PRA's supervisory style heralded a break with the past 'light-touch' regulatory philosophy. In their initial plans for regulatory reform, HM Treasury emphasized the need for greater use of supervisory judgement, based on forward looking analysis, and a requirement for financial organizations to comply not only with the letter of the law but also the spirit. This had also been recognized by the FSA, and prior to its demise the CEO, Hector Sants, signalled that more judgements would be required, with a focus on more intrusive and 'outcome focused' supervision (FSA, 2010a). This was echoed in the document which set out how the Prudential Regulatory Authority would operate, 'the PRA's approach to supervisory assessment will be based on forward looking judgements, with supervisory interventions clearly directed at reducing the major risks to the stability of the system' (Bank of England & Financial Services Authority, 2012). The PRA was to continue with a risk-based approach to regulatory resource allocation, but was to perform the risk-assessment based more on future risks, and the risk to its statutory objective of financial stability.

The PRA's supervisory approach document also set out the PRA's expectations of the firms that it regulates. It stated that it would require 'firms to submit sufficient data, of appropriate quality, to inform their [supervisors'] judgements about key risks' (Bank of England & Financial Services Authority, 2012, p. 31). In addition, where the PRA makes recommendations for remedial actions to mitigate risks that have been identified, it expects 'firms to implement these recommendations in the spirit as well as to the letter' (Bank of England & Financial Services Authority, 2012, p. 30). Finally, the report states that 'firms should not approach their relationship with the PRA as a negotiation' (Bank of England & Financial Services Authority, 2012, p. 35), signalling that the PRA intended to adopt a tougher and more challenging attitude.

Ferran (2012b) suggests that this increase in judgement-led supervision, which allows for significant supervisory discretion, was somewhat at odds with the more prescriptive rules that were being made at an EU level. Unlike the implementation of Basel 2, which allowed room for national authorities to manoeuvre, the Capital Requirements Regulation 4 applied directly in the UK, with no discretion for the PRA to change the rules. The PRA issued a consultation paper and a series of supervisory statements[50] explaining how CRD 4 was to be implemented for credit risk, counterparty risk, market risk etc. (Prudential Regulation Authority, 2013a, 2013b, 2013c, 2013d). This work was completed in December 2013. Further statements and updates related to the EU delegated acts on liquidity and the leverage ratio were released by the PRA throughout 2014 (Prudential Regulation Authority, 2014a, 2015a) and 2015. As Figure 3.4 shows, the majority of the final EU and UK regulations and detailed standards were being published at the same time as the fieldwork for this study was conducted in 2013-4.

The three orders of post-crisis regulatory change

This chapter has endeavoured to highlight the key prudential regulatory changes that have occurred since the financial crisis, and it is worth summarizing these here to set the scene for the following empirical chapters. This section draws on Hall's typology of policy change (Hall, 1993), as applied to regulation by Black (2005, pp. 9-11). First order changes occur when the settings or levels of regulatory instruments are recalibrated (Hall, 1993, p. 278). Many of the changes that were introduced in the Basel 3 and CRR/CRD 4 standards fit into this category of change, such as the changes to the

[50] Supervisory statements articulate the PRA's expectations for firms to help firms determine whether they are meeting those expectations. They do not have the status of legal regulatory requirements.

definition of financial instruments that can be considered as regulatory capital or the very technical amendments made to the calculation of counterparty credit risk. A small change, such as the recalibration of the correlation factor for financial institutions can actually have significant financial and operational impacts. When all these changes are combined, they amount to a complex set of new or amended requirements which banks will have to navigate to achieve compliance.

The introduction of the leverage ratio, the rules for liquidity risk and countercyclical buffers as part of Basel 3 are examples of second order changes, 'where the instruments of policy as well as their settings are altered' (Hall, 1993, p. 279). In addition, changes to the regulatory structures, such as the disbanding of the FSA and the creation of the PRA and the FCA can also be considered to be second-order changes, as can the creation of the ESRB and ESAs at an EU level. These new authorities have added to the already complicated constellation of actors responsible for standard-setting and regulatory supervision. For an internationally active bank operating in many jurisdictions, working out which rules apply where and who will be responsible for their supervision can be an onerous task. In terms of standard setting, layers of complexity are added, particularly at the EU level, when the political interests of Member States are added into the mix. This can add additional provisions to the rules to accommodate special cases and exceptions, and given the nature of legal documents, these can be difficult to navigate. For banks in the UK, the move from one supervisor to two, the PRA and the FCA, also had the potential to further complicate how regulatory relationships were managed. Finally, the changing approaches to regulatory supervision – from 'light-touch' regulation to a more interventionist style are also a second-order change, which, it has been argued, stems directly from the cognitive shifts associated with third-order changes.

Baker (2013) considers the ideational shift towards macro-prudential regulation and the need for greater public intervention in the markets to be a third-order change, a change in the interpretive frame through which prudential regulation is understood. These third order changes occurred not only at a global and EU level but also in the UK. As described above, underlying assumptions about the social value of banks and the efficiency of markets and financial innovation were publicly questioned. The abandonment of the rhetoric of 'light touch regulation' and the introduction of the discourse of 'intensive supervision' was one indication of this third order shift, as was the increased use of macro-prudential tools by the Bank of England, such as the FPC's requirement for banks to raise additional capital in 2012 (Treanor, 2012).

It is also worth noting that the financial regulatory reform in the UK after the crisis was not limited to prudential regulation. Changes were also being made to conduct of business regulation[51] and new requirements for banks to have recovery and resolution plans were brought into force[52]. The reforms governing how banks in the UK should be structured were also introduced[53]. Finally, banks also had to determine how these other regulations would interact with the new prudential regime.

The changing regulatory environment of banks operating in the UK was therefore very complex, with shifts occurring at several levels simultaneously, leading to significant levels of uncertainty. Perhaps most profound and destabilizing were the changes to the intellectual underpinnings of the previous regime that led to questions about the role of banks in society, the legitimacy of some of their activities (such as securitization) and how far the regulator should be able to intervene in their business and risk management processes. The following empirical chapters examine how banks in the UK responded to these changes, beginning with the types of narratives that these organizations constructed in response to this uncertain and dynamic regulatory environment.

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[51] This was largely through the introduction of MIFID II (Markets In Financial Instruments Directive) at an EU level (European Parliament and Council of the European Union, 2014b). MIFID I set out the rules that investment firms must follow in conducting their business, and includes reporting requirements for preventing market abuse, trade transparency requirements for equities, rules for investor protection, and rules for off-exchange markets. MIFID II extends these requirements to cover off-exchange derivatives, more stringent rules for investor protection and strengthened supervisory powers.

[52] Recovery and resolution plans set out how a bank would return to viability in situations of severe financial pressure and if this fails, the steps that would be taken to ensure an orderly resolution to avoid the need for state aid and to prevent further financial instability. The key legislative text is the Bank and Recovery Resolution Directive (European Parliament and Council of the European Union, 2014a)

[53] The Independent Commission on Banking considered the need for structural reforms to be made to the UK banking industry and came up with a series of recommendations (Independent Commission on Banking, 2011), which included the 'ring-fencing' of banks' retail activities from wholesale activities, to insulate the former from any problems in the wider bank or financial system. These reforms have been implemented via the Financial Services (Banking Reform) Act 2013.

Chapter 4: Regulatory change: banks' public responses

In order to be viable, organizations must adapt to their environments, requiring them to manage the uncertainty that this necessarily entails (Duncan, 1972). In the aftermath of the global financial crisis, which some UK banks barely survived, the substantial changes in prudential regulation (see Chapter 3) created an environment of considerable complexity and uncertainty. This chapter explores the public statements that the five largest UK banks made in response to this environment. These public representations are 'stage-managed' portrayals of a specific 'organizational self', akin to Goffman's 'front stage' behaviour (Goffman, 1969). As such, the discourse and rhetoric adopted in banks' statements about regulatory change cannot be taken as indicative of the changes in their 'back stage' behavior. Nonetheless, as this chapter demonstrates, the manner in which these banks represented themselves in relation to regulatory reform changed over time and in ways that suggest these organizations failed to immediately grasp the full consequences of their role in the near collapse of the financial system. The intention is to give a broad sense of the nature of these responses at an organizational field level (DiMaggio & Powell, 1983) before the remaining chapters go on to discuss the more detailed types of response revealed during the fieldwork interviews.

Organizational theorists suggest a repertoire of possible strategies are available to organizations in response to the institutional pressures which create environmental change (DiMaggio & Powell, 1983; Greenwood et al., 2011; Kraatz & Block, 2008; Oliver, 1991; Pache & Santos, 2010). According to Oliver (1991), these can include acquiescence, compromise, avoidance, manipulation and defiance (see Chapter 1). Several environmental and organizational factors have been posited to explain or predict why or how an organization might adopt a particular response. These include levels of environmental uncertainty, the multiplicity of demands and the level of legal coercion (Oliver, 1991), the nature of the institutional demands (Pache & Santos, 2010), the position of the organization in the organizational field or the ownership and governance structure of the organization (Greenwood et al., 2011). This chapter considers organizational legitimacy to be a critical factor for banks when discussing regulatory change. However, because organizations inhabit a pluralistic institutional environment, consisting of multiple demands, multiple discourses and multiple institutionally-derived identities (Kraatz & Block, 2008), legitimacy is conferred by multiple institutional referents. Navigating plural legitimacy criteria is therefore crucial for organizational survival, and the changing discourses used by banks to discuss regulatory change are indicative of the struggles and tensions in balancing the demands of external constituencies (Deephouse & Suchman, 2008; Kraatz & Block, 2008; Suchman, 1995).

The institutional logics perspective can add further nuance to the understanding of how organizations discuss changes in their external environments. To recap briefly, the theory of institutional logics suggests that society is composed of a number of institutional orders which are family, community, religion, state, market, profession and corporation (Thornton et al., 2012, p. 73). Each of these has a particular organizing logic that patterns behavior and infuses that behavior with meaning. Institutional logics comprise both symbolic[54] constructions - ideas and meanings – as well as material aspects such as practices and structures. Organizational environments can comprise a multiplicity of institutional logics, and therefore the uncertainty of change in one institutional logic – such as regulation – is exacerbated by the conflicts and tensions between other dominant logics in the organizational field, such as the logic of the market. However, at the same time, institutional logics can also be seen to provide organizations with rationalities and organizing principles for navigating an unpredictable environment and for making sense internally of the external environment.

This chapter uses institutional logics as a heuristic device to explore how five UK banks (Barclays, HSBC, Lloyds, RBS and Standard Chartered) discussed regulatory reform in their annual reports and regulatory consultation responses from 2006 - 2013. It focuses on the symbolic aspects of institutional logics because these are most readily available for analysis in texts. Phillips et al. (2004) also argue that 'texts that leave traces' such as

[54] It is important to be clear about the meaning of the term 'symbolic' as it is used here. In literature on regulatory compliance, organizations can be said to symbolically rather than substantively comply (Edelman, 1990, 1992; Edelman & Suchman, 1997) when they give the appearance of conformity to rules rather than substantive adherence. However, the use here is specifically related to the ideational and discursive aspects of an institutional logic, and the use of such by an organization or organizational actor which may indicate either substantive or ceremonial compliance with external institutional pressures.

various types of public corporate reports are 'likely to be generated to secure and maintain legitimacy' (Phillips et al., 2004, p. 642). Annual reports and regulatory consultation responses are produced by firms for different audiences and to serve different purposes. Even though there are legal requirements for public companies to publish annual reports, these documents are also used by these companies to fulfil other objectives (Stanton & Stanton, 2002). These may be to communicate information to a firm's stakeholders (customers, suppliers, investors, regulators), as a marketing tool for impression management (Neu, Warsame, & Pedwell, 1998), a vehicle for maintaining or repairing legitimacy (Suchman, 1995) or finally, as a mechanism for providing accountability to the firm's shareholders (Stanton & Stanton, 2002). Responses to regulatory consultations are produced by firms with a more specific intention, to assert their particular positions on regulatory proposals in an attempt to influence the final policy outcome (Pagliari & Young, 2014). The primary audience, therefore, is the relevant standard setting body, but because these documents are publicly available, they may also be read by their peers, other regulatory authorities and other interested parties.

The chapter proceeds first by explaining how the discourse analysis revealed the existence of market and regulatory logics in banks' statements on regulatory change and the theoretical framework of institutional logics that was developed as a means of interpreting that data. The findings of this work then show how banks mobilized these distinct logics over time in response to the uncertainty of regulatory change, and how this varied over time and between different organizations. Finally, the chapter ends by presenting three explanations to account for these variations including the degree and type of uncertainty, a bank's position in the organizational field and the nature of prudential regulation itself.

Developing and applying regulatory and market logic

The lens of institutional logics was a useful means for interpreting banks' discussions of regulatory change because textual elements commensurate with the symbolic representations of institutional logics (comprising theories, frames and narratives (Thornton et al., 2012)), emerged inductively during the 'bottom up' coding process (see

Chapter 2). This section describes how the institutional logics of the market and regulation were then captured using what Reay and Jones (2015) describe as ‘pattern inducing’, which uses a grounded theory approach to allow the logics to emerge purely inductively from the data.

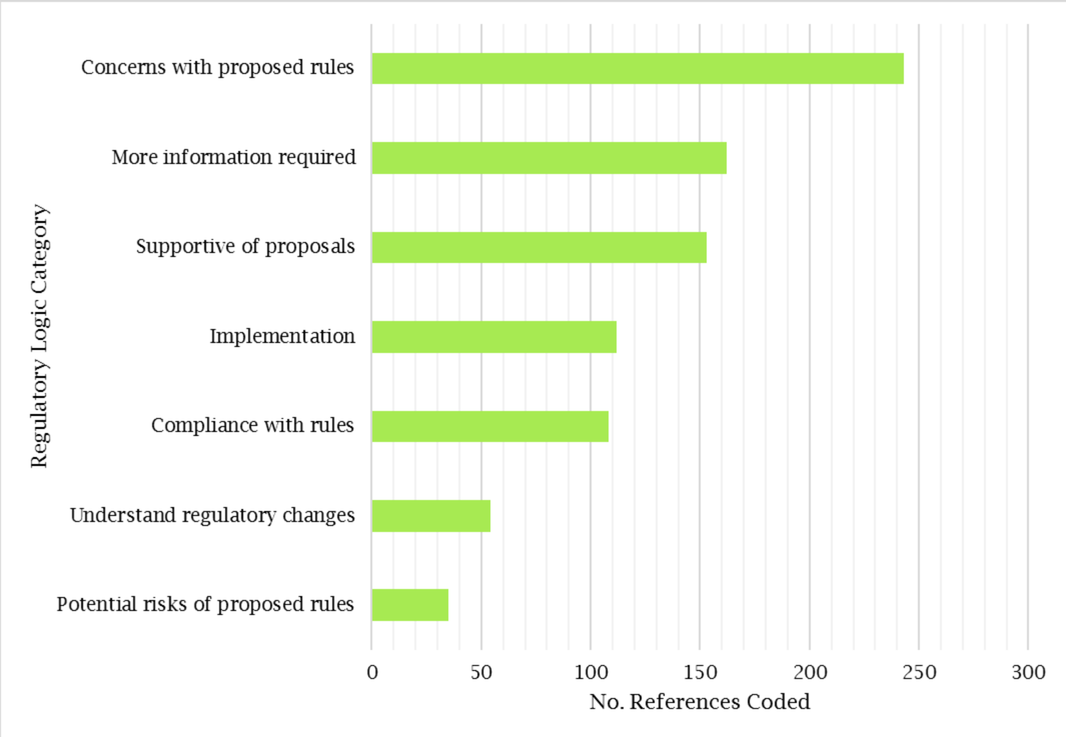
The two logics that were found to be most prevalent in the banks’ arguments about regulatory change were regulatory logic and market logic. Discussions about regulatory change from the perspective of regulatory logic tended to involve the language of regulatory compliance, of progress towards implementation and of support and recognition for the need for regulatory change. Any concerns with the proposed amendments to the existing rules were expressed in the technocratic terms also used by the standard setters, policy makers and supervisory authorities. Market logic, however, infused arguments that cited the negative effects of the new prudential rules on banks’ profitability, economic growth and the competitive position of the UK banking industry. This discourse echoed broader societal narratives about the importance of market efficiency, the central role that banks play in the UK economy and the importance of retaining a competitive financial sector in the UK. The discussion below focuses on how market and regulatory logics were used by the banks and gives examples of textual elements coded to each logic.

Regulatory logic categories

The textual elements in the banks’ documents which articulated regulatory logic were aggregated into seven broad categories (see Figure 4.1) which are explained below and examples of which are given in Table 4.1.

Concerns with proposed rules: As might be expected in the analysis of regulatory consultation responses (and to a lesser extent, the annual reports), the banks in the sample addressed many of their comments about regulatory change to the substantive content of the proposed new rules. Rather than disagreeing with the rules on principle or for reasons more associated with market logic (see below), the concerns underpinned by regulatory logic tended to focus on the technical or conceptual flaws within the rules themselves. For example, banks highlighted inconsistencies between different aspects of the proposals or between the liquidity and capital rules. There were also significant amounts of comments that proposed alternative approaches, often accompanied by supporting empirical evidence or recourse to academic research. Banks also questioned regulatory proposals which appeared to be in conflict with the stated aims or which might create perverse incentives that were not intended.

Figure 4.1 Regulatory logic categories 2006-2013



Source: Annual reports, consultation responses

More information required: Demonstrating the lack of clarity and uncertainty in the rule-making process, about a fifth of the references coded to regulatory logic requested additional guidance, and/or further information on the proposed rules before the banks could provide meaningful comments. In some cases, the banks were requesting specifics regarding the level at which the new regulatory measures had been set and how they had been calibrated. A large proportion of these requests were in response to the PRA's consultation papers as opposed to those produced by the Basel Committee or the European Commission. This suggests that the banks expected to enter into a dialogue with the PRA to obtain greater clarity, and were aware that this would be less likely to occur with the regional and international standard setters.

Supportive of proposals: The banks made broad statements in support of the overall regulatory objectives. Whilst these responses have been coded to regulatory logic, it should be noted that they were sometimes caveated with concerns about the detail of how the objectives would be achieved. These caveats were coded to reflect market logic.

Implementation: This category was focused on the information that the five UK banks gave in their documents about their progress towards implementing the new rules and the associated changes they had already made or were making to their business operations. The banks also offered assurances that they would be ready to meet the regulatory deadlines.

Compliance with rules: On a similar theme, and in every bank annual report since 2009, there were statements about how the banks were meeting the current regulatory capital requirements, or were already meeting the new requirements for liquidity or capital or that they would be meeting these requirements by the regulatory deadline. So, despite many references to the potential adverse impacts of increasing capital requirements (see below), at the same time, the banks were indicating their ability to comply with the new or existing regulatory rules.

Understand regulatory changes: In responding to the regulatory consultation papers, the banks were demonstrating clear engagement with the technical content of the proposed rules. However, the discourse analysis revealed that the banks also presented their understanding of the changing regulatory environment in the annual reports, which often included descriptions of how the organization monitored regulatory developments. In addition, the banks stressed that they were analyzing the new rules to determine the changes that they needed to make to their systems and processes in order to be compliant with the new regulations.

Risks of proposed rules: Finally, the banks alluded to two key risks with the new regulatory proposals. The first was that the rules as they were written might have the unintended consequence of shifting what have traditionally been banking activities (such as lending) to the 'unregulated' or 'shadow banking' sector[55]. The second risk was that the new rules might lead to a divergence between the rules and models that banks use to calculate regulatory capital and those that are required for risk management purposes. This argument derived from the Basel 2 requirement for banks to use their own estimates of risk parameters in both regulatory capital calculations and in the day-to-day risk management of the firm (BCBS, 2006c). In allowing there to be different rules for regulatory capital and risk management, this argument claims, the credibility of the risk models might be questioned, resulting in poorer levels of risk management.

Examples of textual elements coded to each of these categories can be found in Table 4.1.

Table 4.1 Examples of regulatory logic

Category	Representative Data	Regulatory Logic Position
Concerns with rules as proposed	*'The proposals on equity minority interest appears faulty, as it causes a mismatch between risk and the capital available to absorb losses arising from those risks, as it completely excludes equity capital that can and does absorb some loss if the risks crystallize.' (Lloyds, 2010b, p. 3)*	Proposed rules are conceptually or technically problematic
	'In the attached Appendix, we propose such an alternative forward-looking framework to compute a CVA Variability Charge ('CVC') which can be calibrated to an individual portfolio and which is not procyclical, is risk sensitive and uses existing tools already required by firms' (HSBC, 2010b, p. 6)	Propose an alternative approach to achieve same regulatory objectives
More information required	*'We would recommend that Basel clarifies its capital treatment for such transactions and whether a CVA risk capital charge is required to be calculated against centrally cleared client exposures' (Royal Bank of Scotland, 2011, p. 4)*	Further regulatory guidance is needed to properly evaluate proposals
	'Standard Chartered would like to understand the derivation of the factors and obtain more clarity where parameters have not been set, e.g. 'increases in market volatilities' would need to be well-defined to enable calculation of the liquidity impact by firms.' (Standard Chartered, 2010b, p. 12)	
Supportive of proposals	*'HSBC fully supports the rationale of the Basel III proposals which require banks to hold more capital. This is absolutely core to ensuring that governments and taxpayers are better protected in future than they have been in the past' (HSBC, 2010a, p. 8)*	Regulatory changes are required to prevent another crisis
	'We fully support the differential modelling of liquidity in the market risk capital framework. We	Agreement with the proposed new rules

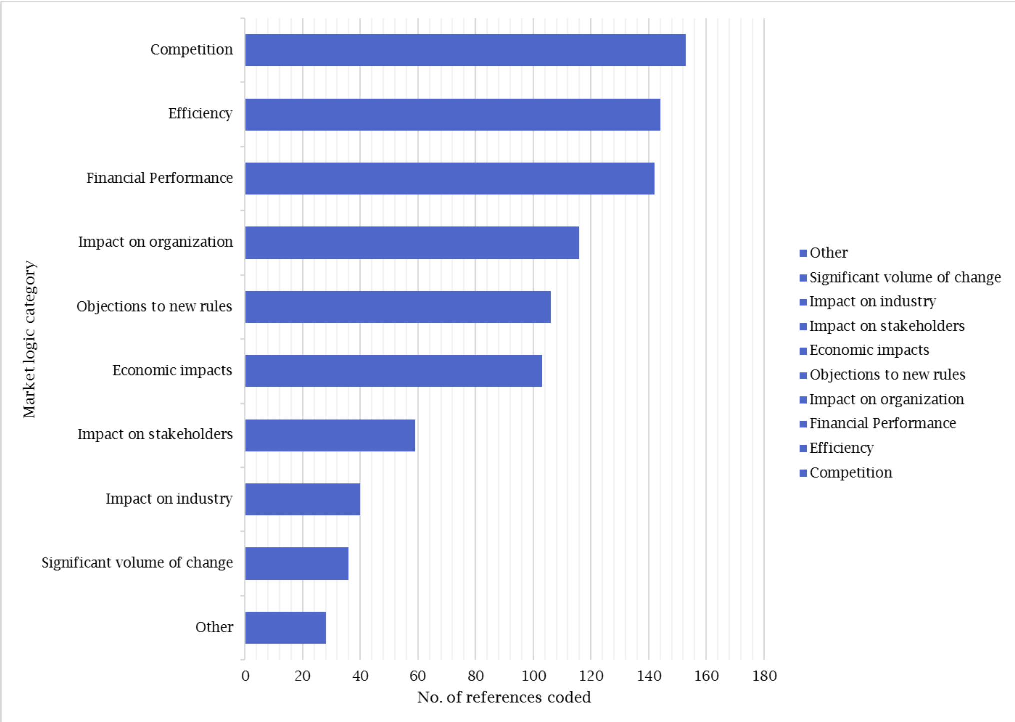
[55] This sector comprises non-banking financial institutions such as hedge funds, money market funds and structured investment vehicles used for securitisation.

Category	Representative Data	Regulatory Logic Position
	can see merit in both a variable liquidity horizon as well as a variable exit costs conceptual framework, and feel that either could be used to support the aims of the Committee' (Royal Bank of Scotland, 2012b, p. 6)	
Implementation	*'Where regulatory change has strategic implications this will tend to affect more than one Principal Risk factor. Such issues are dealt with on a Group wide basis by cross-disciplinary teams working under an accountable executive reporting to senior management' (Barclays, 2010a, p. 7)*	Implementation of regulatory change is taken seriously by this organization
	'The actions already announced to right size the balance sheet are expected to ensure compliance with the future minimum standards, which are expected to be 100 per cent for both ratios by their respective effective dates.' (Lloyds, 2010a, p. 95)	The organization is already working to meet the new regulatory requirements on time
Compliance with rules	*'In terms of Basel III, we already meet the requirements of 100 per cent for both the Net Stable Funding Ratio and the Liquidity Coverage Ratio, well ahead of the required implementation date.' (Standard Chartered, 2011, p. 82)*	The organization is already in compliance with the new rules
	'The strength of our capital ratios, our ability to generate capital organically and our actions to optimise RWAs will enable us to meet our targeted capital ratios under CRD4.' (Barclays, 2011, p. 9)	The organization will be able to achieve compliance with the new regulatory rules
Understand regulatory changes	*'The Group continues to work to assess the impact that the reforms may have on its business and continues to play a constructive role in the debate with the Government and other stakeholders.' (Lloyds, 2011, p. 21)*	The organization is working to understand the impacts of the new regulatory rules.
	'It is critical that the Group both understands early on the drivers for this [regulatory] change and be able to assess the potential impact of prospective rules and regulations on the different businesses. The regulatory developments tracker seeks to identify, track and monitor all such material changes and ensure that an appointed senior executive is responsible for assessing the potential impacts on the Group's business' (Royal Bank of Scotland, 2010a, p. 202)	The organization actively tracks regulatory changes and ensures senior management is involved.
Risks of proposed rules	*'Another impact of bank deleveraging and price increases resulting from the proposals is that bank customers will look elsewhere for services currently provided by banks. This is likely to result in more financial services being provided outside regulatory control, which would increase the systemic risk from the financial sector.' (Lloyds, 2010b, p. 3)*	There is a risk that some bank activities will move to the unregulated sector
	'We would strongly caution against any new measures that would have to be developed for capital buffer purposes only. Such measures would have limited or no link with internal risk management processes, and their credibility would pose a constant challenge' (HSBC, 2010b, p. 26)	There is a risk of divergence between requirements for regulatory capital and for risk management.

Market logic categories

The coding categories that represented market logic are explained below and shown in Figure 4.2, which also illustrates the proportion of textual references coded to each category. Table 4.2 gives examples of extracts from the annual reports and consultation responses that were coded to each of these categories.

Figure 4.2 Market logic categories 2006-2013



Source: Bank annual reports and regulatory consultation responses

Competition: As can be seen in Figure 4.2 the largest category of market logic used by banks was that of 'competition'. Banks made three key arguments in this category – the need for international consistency in both the development of regulatory rules and their implementation, the requirement of a 'level playing field' for all banks in all jurisdictions and thirdly, the potential for the new rules to adversely impact competitiveness. The banks appeared to be concerned that the regulatory reform in the UK would be more stringent than that in other countries which they claimed would damage the competitiveness of the UK banking industry. This view resonates with the pre-2008 consensus amongst politicians and regulators of the vital role of the financial sector in the British economy and the need to maintain the competitiveness of the City of London (Engelen et al., 2012; Norfield, 2016).

Efficiency: Banks' views about efficiency were largely concerned with the practicalities of implementing the new rules and consisted of general objections about the scale and speed of the implementation timescales as well as specific technical or operational difficulties. At their core, these arguments were about how banks allocated their resources and operational efficiency. The latter is a measure of how many resources (cost, time and people) are required to produce outputs (such as revenue). For banks, implementing regulation involved significant resources without a commensurate increase in outputs, a situation regarded by financial theories associated with market logic as inefficient. This explains why in several instances, banks used words such as 'burden', 'onerous' or 'impractical' in relation to the proposed changes.

Financial performance: The five UK banks also discussed their response to regulatory change in terms of the impact on their future financial performance. In the majority of cases, the banks did not allude directly to reduced profits or revenue. Instead, they framed their responses in terms of the disproportionate nature of the capital requirements, the increased costs of regulatory compliance or vague references to their future financial condition. Where profitability was explicitly mentioned, it was in general terms only and phrased as a potential impact of the new rules.

Impact on organization: Bank narratives in this category focused on two key aspects – the potential for negative or adverse consequences for their specific organizations and the need to quantify the impacts of the new rules on their capital positions. Potential adverse impacts cited included changes to the products and services the banks would be able to offer customers, the value of assets and the way the bank operated. In many cases, the nature of the impacts was not specified. All the references in this category were found in the bank's annual reports, documents aimed at investors which must include risks that could impact on shareholder returns. Accountability to shareholders is a core principle of market logic.

In addition, all five banks quantified and disclosed how the new capital rules were likely to affect their core equity Tier 1 capital (CET1) ratios. Essentially, CET1 is a measure of a bank's financial strength based on the ratio of equity capital to its total risk-weighted assets and used by both regulators and investors alike to assess the solvency of a banking organization. Again, these disclosures were contained solely in the annual reports and their inclusion is likely to have been motivated by a need to inform investors and market analysts of the impact of the new regulations.

Objections to new rules: In their responses to the proposed regulatory rules, banks voiced three separate criticisms. By far the most frequent position was that the rules themselves were too stringent, references to which were found in over 50% of the banks' documents dated 2009 or later. Terms such as 'severe', 'disproportionate', 'draconian', 'punitive' and 'harsh' were used to describe the new capital and liquidity requirements. At the heart of these objections was the premise that it is more expensive to fund a business by raising equity than it is by raising debt because the interest paid over the lifetime of a loan (debt) would be less than the proportion of profits foregone to the equity owners. Banks were therefore claiming that increasing the level of regulatory capital requirements (equity) would be more costly and might even reduce lending because it is more expensive to fund loans via equity.

Economic impacts: According to the banks, the proposed increases in capital requirements had the potential to damage economic recovery through a reduction in bank lending and credit creation. In 17 out of 25 of the bank annual reports between 2009 and 2013, the CEO review or Chairman's statement mentioned the importance of striking a balance between financial stability through prudential regulation on one hand and economic growth and recovery on the other.

Whilst the validity of this argument has been heavily contested (Admati, DeMarzo, Hellwig, & Pfleiderer, 2011; Allen, Chan, Milne, & Thomas, 2012; Caruana, 2010; Miles, Yang, & Marcheggiano, 2013; Santos & Elliott, 2012; Yan, Hall, & Turner, 2012), the consistency of this argument amongst the banking industry (Institute of International Finance, 2011) was representative of market logic, but one which purported to appeal not just to the self-interest of the banks but to an apparent concern for broader economic wellbeing.

Impact on stakeholders: Stakeholders here refers to both the shareholders and customers of the banks. In terms of shareholders, many of the arguments about potential adverse effects on financial performance or the disproportionate cost would, according to market logic, have a knock-on impact on shareholder returns. This category, however, includes textual references that explicitly state this in terms of a reduction in returns on equity[56], leading to a decrease in the returns an investor would receive. In relation to the impact on customers, the banks' main assertion was that they would have no alternative but to pass on the increased capital and liquidity costs to their customers in the form of higher prices.

Impact on industry: Many of the arguments already discussed were also used by the banks to indicate where the regulatory reforms could be detrimental to the whole UK banking industry, especially in terms of competition. In addition, the banks contended that the liquidity reforms in particular had the potential to affect the financial markets, increasing volatility, reducing liquidity or other destabilizing effects. This is clearly in line with the market logic framing of minimal regulatory intervention in the market.

Volume of change: Finally, in over three quarters of the 2009-2013 annual reports, all five UK banks made reference to the scale of the proposed regulatory reforms. This 'unprecedented' (Royal Bank of Scotland, 2010a, p. 19) level of regulatory change was generally couched as a risk to the bank which would have strategic implications, most of which were captured by the other categories discussed above.

Table 4.2 provides samples of text from both the annual reports and consultation responses that were coded to each of these categories.

[56] A measure of profitability used by market participants to make investment decisions.

Table 4.2 Examples of market logic

Category	Representative Data	Market Logic Position
Competition	*'We would emphasise the importance of a globally consistent regulatory framework, that does not place banks operating in the EU at significant competitive disadvantage to those located in other jurisdictions' (Royal Bank of Scotland, 2010c, p. 6)*	Competitiveness of the UK will be damaged by inconsistent global regulatory rules
	'In order to maximise the contribution of UK banks to society, we must be allowed to compete on a level playing field within a secure regulatory framework.' (Barclays, 2010a, p. 8)	UK banking industry is important to society and must remain competitive
Efficiency	*'The requirement to inform the PRA of differences in the capital requirements under CRR and BiPRU potentially necessitates two methods of calculation to be run' (Lloyds, 2013, p. 12)*	Regulatory changes incur significant operational costs
	'So many of HSBC's people have exemplified commitment and endeavour again in 2010, helping our customers and clients to meet their financial objectives while taking on the additional burden of preparing for regulatory change.' (HSBC, 2010a, p. 6)	Regulatory change is a burden
Financial Performance	*'There are a number of factors that might affect our performance. First of all, the material and increasing drag on both income and costs from an ever more complex set of regulatory requirements.' (Standard Chartered, 2011, p. 4)*	Regulation is reducing income and increasing costs, therefore reducing profitability
	'It is clear from the above that the industry will continue to bear a heavy burden of both time commitment and cost as it works with policymakers to finalise the regulatory reforms' (HSBC, 2011, p. 5)	Implementing regulatory changes impacts our cost/income ratio
Impact on organization	*'The rules are currently in draft and subject to ongoing negotiation. If they were to be finalised in their current form, the holdings of such positions would generate a disproportionate capital cost and potentially the relevant business could be curtailed, closed or our hedging would be adjusted to negate the impact.' (HSBC, 2012, p. 290)*	Regulatory changes will impact our profitability and business model
	'Although the CRD 4 rules have not been finalised, we expect our CET1 ratio would be around 100 bp[57] lower than our reported Basel II Core Tier 1 ratio on a pro forma basis.' (Standard Chartered, 2012, p. 121)	The new rules will reduce our capital strength
Objections to new rules	*'It is clear from the analysis that the impact of the proposed capital and liquidity reforms will be severe' (Barclays, 2010c, p. 1)*	Rules are too stringent
	'However, RBS finds that the current implementation would result in an amount of capital that is hugely disproportionate compared to the economic risk. This would result in a material divergence between capital and risk' (Royal Bank of Scotland, 2010b, p. 4)	New rules are disproportionate in the amount of capital they require
Economic impacts	*'The cumulative impact of proposed regulatory changes would negatively impact the economy and process of recovery' (Barclays, 2010b, p. 2)*	Banks' role in credit creation is important to economic growth
	'It is imperative to strike the right balance between strengthening the financial system and supporting economic growth.' (HSBC, 2009, p. 5)	If capital requirements are set too high, banks will not be able to lend as much

[57] 100bp refers to one hundred basis points, which is the equivalent of a 1% change in the CET1 ratio.

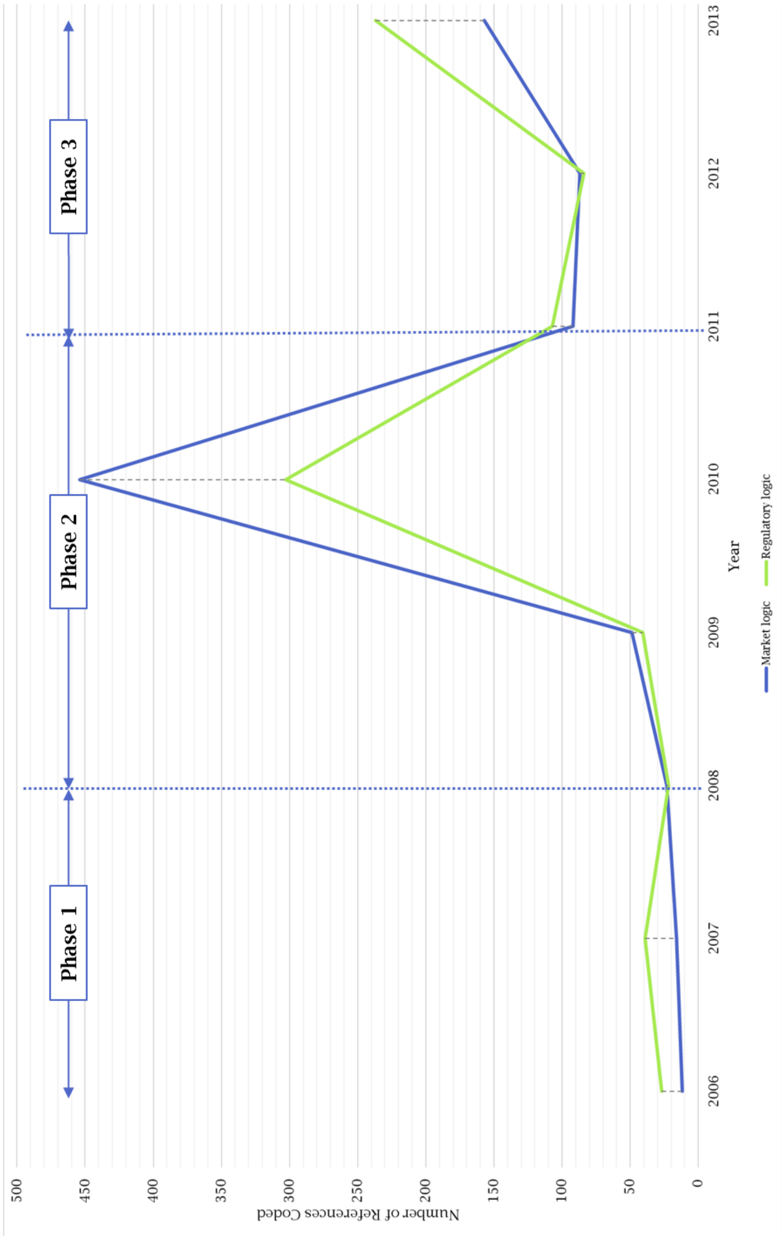
Category	Representative Data	Market Logic Position
Impact on stakeholders	*'The vast bulk of the price increases resulting from the proposals will fall on new lending and lending to small and medium sized enterprises, and there will be much reduced lending capacity available' (LLoyds, 2010c, p. 3)*	Increased costs of regulation will be passed on to our customers
	'This work makes clear that significantly increasing prudential requirements will reduce bank's return on equity to unattractive levels for investors.' (Royal Bank of Scotland, 2010b, p. 2)	Shareholder value and the share price are a key concern and should not be negatively impacted by regulation
Impact on industry	*'Proposed changes could also adversely affect economic growth, the volatility and liquidity of the financial markets and, consequently, the way we conduct business, structure our global operating model and manage capital and liquidity.' (Standard Chartered, 2013a, p. 66)*	Adverse effects on the financial markets
	'Imposing a restriction on ordinary market-making activity within the trading book may well drive the business to less regulated sectors of the market, increasing costs and reducing both liquidity and price transparency.' (HSBC, 2010c, p. 8)	Regulatory changes may reduce the efficient functioning of the markets
Significant volume of change	*'The banking industry continues to be subject to unprecedented levels of regulatory change and scrutiny in many of the countries in which the Group operates.' (Barclays, 2012, p. 113)*	High volume of regulatory change
	'The level of industry regulation and its speed of change has never been greater.' (Lloyds, 2010a, p. 6)	

Variation in banks' use of market and regulatory logic over time

Previous studies on institutional logics have demonstrated that the presence and dominance of logics in a particular organization or organizational field is not static over time (Durand et al., 2013; Greenwood et al., 2010; Jarzabkowski, Matthiesen, & Van de Ven, 2008; Lounsbury, 2007; Reay & Hinings, 2005, 2009; Thornton, 2004; Thornton & Ocasio, 1999). Indeed, given that organizational environments are often characterized by uncertainty, the tensions and conflicts between institutional logics will fluctuate over time. This was the case with the UK financial regulatory environment after the crisis. This section discusses three distinct temporal phases which emerged from the discourse analysis, exhibiting clear differences in how banks were employing institutional logics as regulatory reforms progressed.

Figure 4.3 presents a summary of the number of textual references that were coded to each of the logics split across the three phases - the first phase was from 2006 – 2008, the second from 2009 – 2010 and the third phase from 2011 – 2013. The volume of comments about regulatory change peaked in 2009 - 2010, which coincides with the time when the bulk of the proposed international prudential regulatory standards were disseminated by the Basel Committee on Banking Supervision (BCBS, 2009a, 2009b, 2009c, 2009d, 2010a, 2010b, 2010c). In the United Kingdom, this was also the year when the new Government was elected which went on to overhaul the UK regulatory architecture. Prior to 2009, there was relatively little discussion of regulatory change, particularly in banks' annual reports.

Figure 4.3 Banks' use of regulatory and market logic in public discourses 2006 - 2013



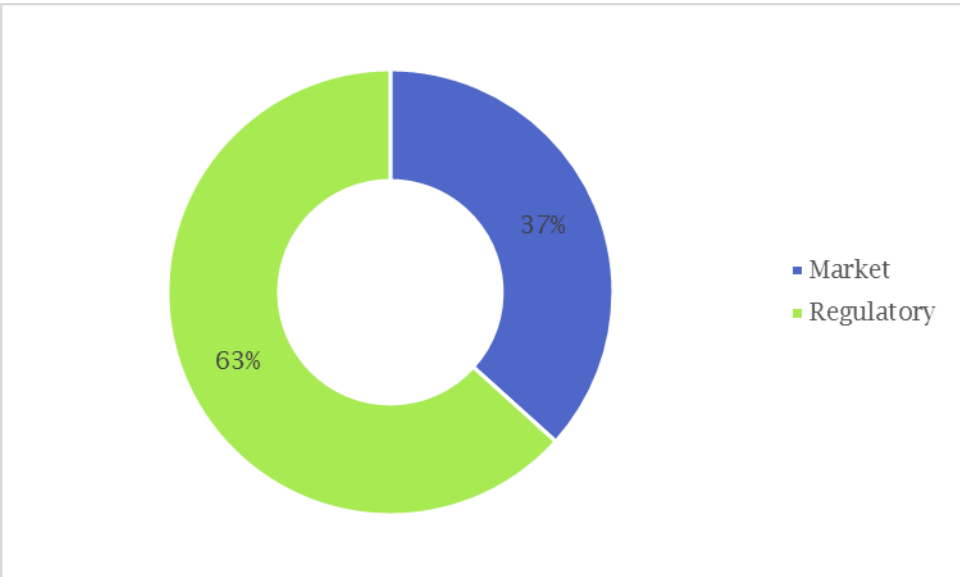
Source: Bank annual reports and regulatory consultation responses

Phase 1: 2006-2008

The beginning of 2007 saw the start of the transition period to the new Basel 2 capital rules, with the final implementation deadline of 1st January 2008. According to the FSA's Business Plan for 2006/7, their supervisory focus vis-à-vis prudential regulation was on the practical implementation of the Basel 2 rules and approving the banks' new risk models (Financial Services Authority, 2006b, p. 19). As seen in Chapter 3, this was coupled with the approach of 'light touch' regulation.

In general, the discussion of regulatory change within bank annual reports was minimal during this period and when it was discussed, neither regulatory or market logics featured very highly though as Figure 4.4 shows, regulatory logic was employed more frequently than market logic.

Figure 4.4 Banks' aggregated use of market vs regulatory logic 2006 - 2008



Source: Bank annual reports and regulatory consultation responses

Indeed, the discourse analysis reveals that the banks were generally supportive of the introduction of the new Basel 2 rules, with the majority of comments relating to their implementation projects and plans to become compliant within the regulatory deadlines. In a number of cases, the receipt of approval from the FSA for the adoption of the advanced risk calculation approaches under Basel 2 was considered an important achievement:

> *'The Group, therefore, will be one of a small number of banks whose risk systems and approaches have achieved the advanced standard for credit [risk], the most sophisticated available under the new Basel 2 framework' (Royal Bank of Scotland, 2007, p. 72)*

Phase 2: 2009 - 2010

The picture changes dramatically after 2008. This was the moment when the scale of the crisis began to become apparent. Lehman Brothers collapsed in the US and the UK government bailed out RBS and Lloyds. Between the beginning of 2009 and the end of 2010, the BCBS, the European Commission, and the FSA produced twelve separate consultation papers setting out new regulatory proposals, on which banks were invited to comment (BCBS, 2009a, 2009b, 2009c, 2009d, 2010c; European Commission, 2009, 2010a, 2010b; Financial Services Authority, 2009a, 2009b, 2009c, 2010a). This volume of consultation papers provided the banks with the maximum opportunity for lobbying and attempting to influence the rule-makers (Salter, 2015; Young, 2012).

From a national perspective, the FSA itself had been criticized for its perceived regulatory failings prior to the crisis and in admission, stated 'clearly this implies that financial authorities in total – finance ministries, central banks and regulators, including the FSA – must have made what in retrospect were serious mistakes' (Financial Services Authority, 2009d, p. 7). In this context, the FSA introduced its enhanced supervision programme (Financial Services Authority, 2008a) which was followed in April 2010 by the Chancellor's announcement of the break-up of the FSA into the FCA and the PRA (see Chapter 3).

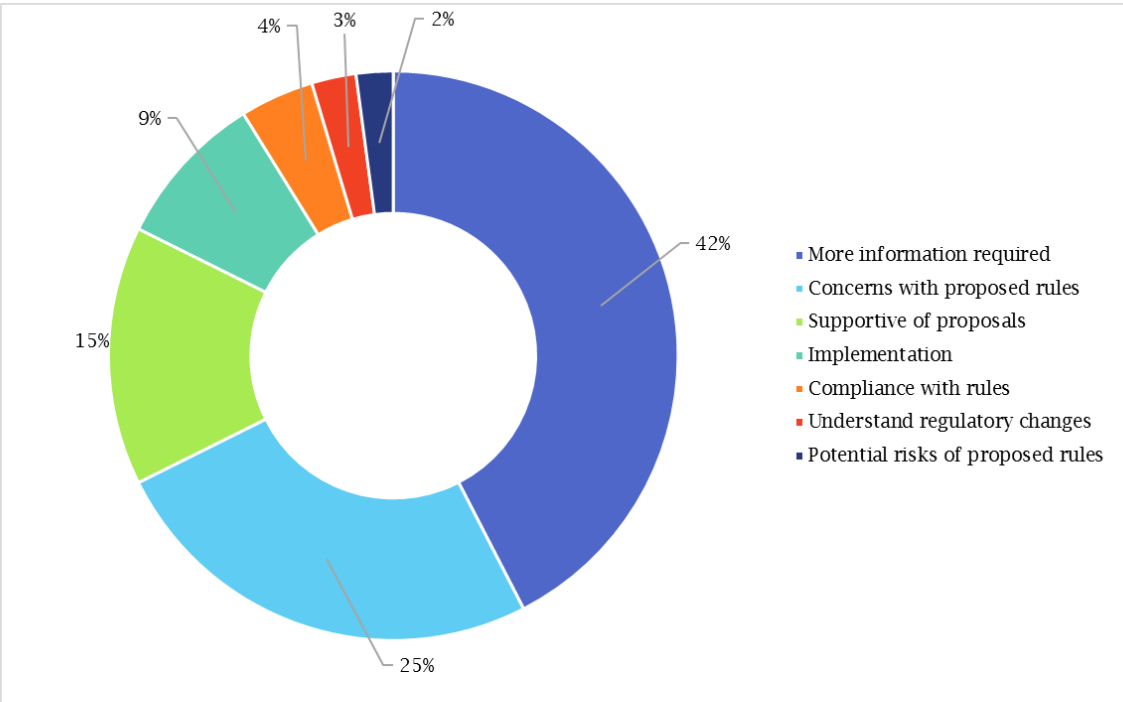
During this period, the discourse analysis reveals a marked increase in the discussion of regulatory change in general. By far the most dominant was market logic, used by the banks to frame their opinions about how the changes might impact their competitive position and operational efficiency and how the rules were too stringent and therefore liable to damage economic recovery because of the impact they might have on banks' ability to lend.

Many of the responses couched in market logic were related to the sense of uncertainty that banks perceived, especially in relation to the general scope and scale of the regulatory changes. From their viewpoint, banks claimed that it was difficult to determine what impact, if any, the changing rules would have on their business in the future:

> *'The precise nature, extent, form and timing of any regulatory changes, as well as the degree to which there will be effective consultation among the various jurisdictions involved, are highly uncertain and thus it is not possible to determine or estimate the likely actual impact on the Group's business and activities.' (HSBC, 2009, p. 16)*

Standard Chartered went even further, stating that 'the regulatory rules of the game are in a state of total flux' (Standard Chartered, 2009, p. 4) and that even though 'a number of changes have been proposed under Basel 3…significant uncertainty remains around the specific application and combined impact of these proposals' (Standard Chartered, 2010a). These can be viewed as expressions of both 'state' and 'effect' uncertainty (Milliken, 1987) – uncertainty about both how the big picture of regulation was changing and what the impacts of that change would be.

Figure 4.5 Regulatory logic categories 2009 – 2010



Source: Bank annual reports and regulatory consultation responses

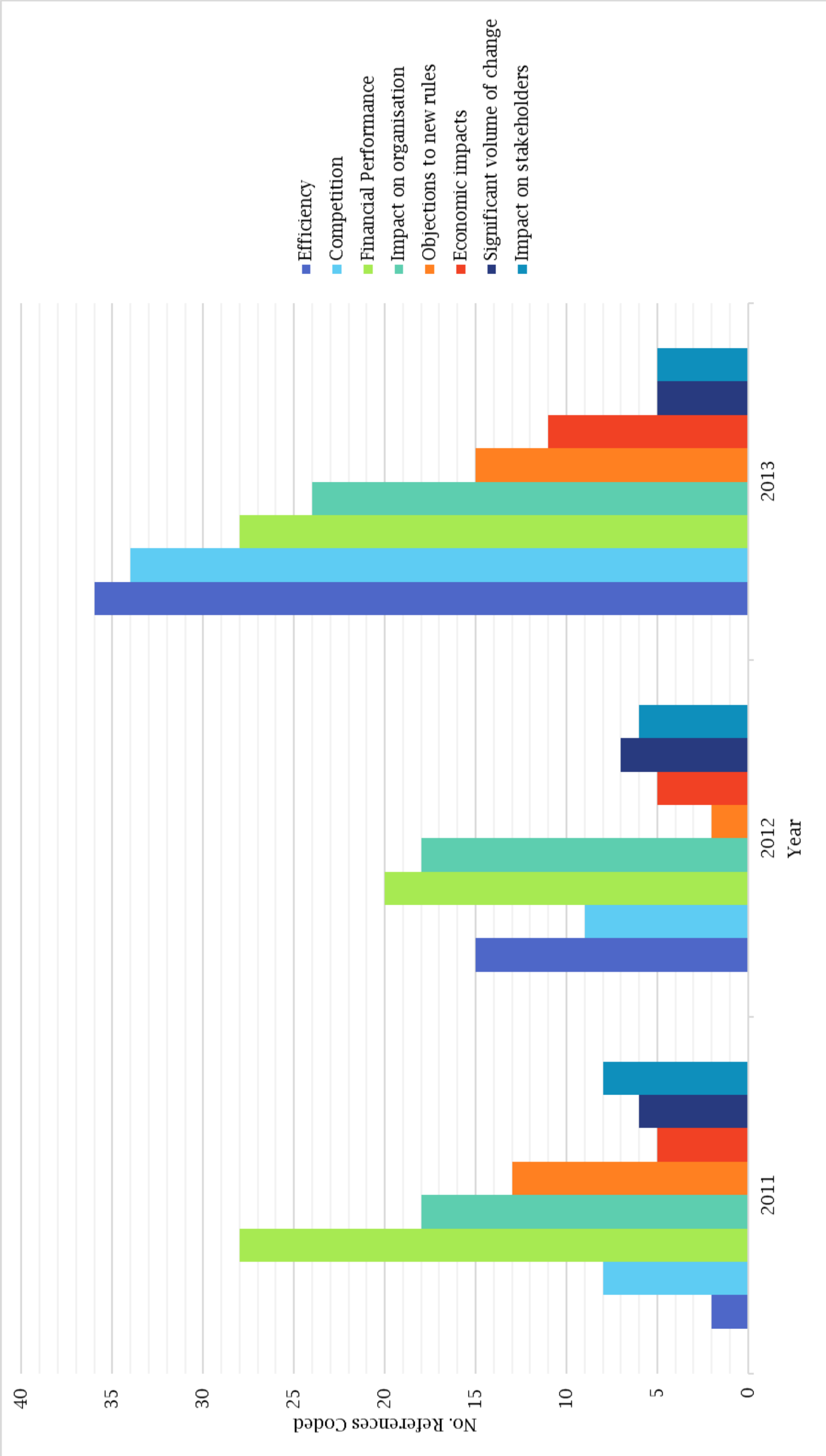
Banks also discussed regulatory change from the perspective of regulatory logic. As Figure 4.5 shows, expressions of concern regarding the proposed rules were most prevalent. Though there was some positive support for the overall objectives, the banks were more likely to highlight areas of contention such as the possible negative impacts or technical flaws. These objections to the technical content of the new rules were perhaps reflective of the banks' substantive engagement with the rules and a desire for standards that would be workable and practical to implement.

Phase 3 – 2011 – 2013

The third phase was marked by a shift from regulatory rule making into implementation and this was reflected in how the banks employed the two institutional logics. The final Basel 3 rules were released by the BCBS at the end of 2010 and revised in 2011 (BCBS, 2010a, 2010b, 2011) and the first European Commission proposals were released in July 2011 (European Commission, 2011a, 2011b). Whilst further lobbying opportunities could still have been pursued in Europe, by and large the high-level standards had been set and the period for transitioning to the new Basel 3 rules was due to begin on 1st January 2014. This period also saw the disbanding of the FSA and the strengthening of powers and changing regulatory approach of its two successor bodies, the FCA and the PRA (see Chapter 3). It is also worth noting that in 2012, Barclays bank admitted to its involvement in the manipulation of LIBOR[58], a scandal in which RBS was also implicated. This was swiftly followed by revelations in 2013 of an investigation into the manipulation of foreign exchange rates by several banks, including RBS, Barclays and HSBC. Such misconduct further damaged the reputation of, and the trust in, the UK banking industry (Grierson, 2012; YouGov, 2012).

[58] LIBOR is the London Inter-bank Offered Rate, the rate of interest at which banks are willing to lend to each other. At the time, LIBOR was an unregulated process, run by the British Banker's Association.

Figure 4.6 Use of market logic 2011 - 2013



Source: Bank annual reports and regulatory consultation responses

The data shows an overall decrease in the use of market logic by the banks over this period (see Figure 4.6), particularly in terms of highlighting the potential negative impacts of the new rules. The focus of banks' responses using market logic switched to considerations of efficiency and competition. The former is the category most associated with the implementation of the regulatory changes, which fits with the broader shift from law-making to execution. More comments were also made with regards to competition, perhaps reflecting a concern about regulatory 'balkanization' and the emerging differences appearing between US and European approaches to banking regulation (The Economist, 2013).

Whilst this period witnessed a reduction in the use of market logic, banks were employing regulatory logic more in their responses to regulatory change, concentrating on requesting more information and clarity and articulating technical concerns with the changing rules. According to the banks, understanding the new rules was also characterized by uncertainty. In an ideal world, regulatory rules would be clear, unambiguous, certain and specific about the criteria for compliance, a position acknowledged by regulators themselves (BCBS, 2013h; Haldane, 2012). However, the debate over the use of rules or principles in regulation (Baldwin, 1995; Black, Hopper, & Band, 2007; Braithwaite, 2002), has shown that regulatory rules are often ambiguous, open to discretion and even co-created through the interaction between organizations and the law (Edelman & Suchman, 1997; Edelman & Talesh, 2011). This caused uncertainty in interpretation and according to the banks, created difficulties in determining what must to be done to achieve compliance.

The primary source of rule uncertainty mentioned in the banks' annual reports and consultation responses related to the lack of clarity and lack of detail contained in the draft rules:

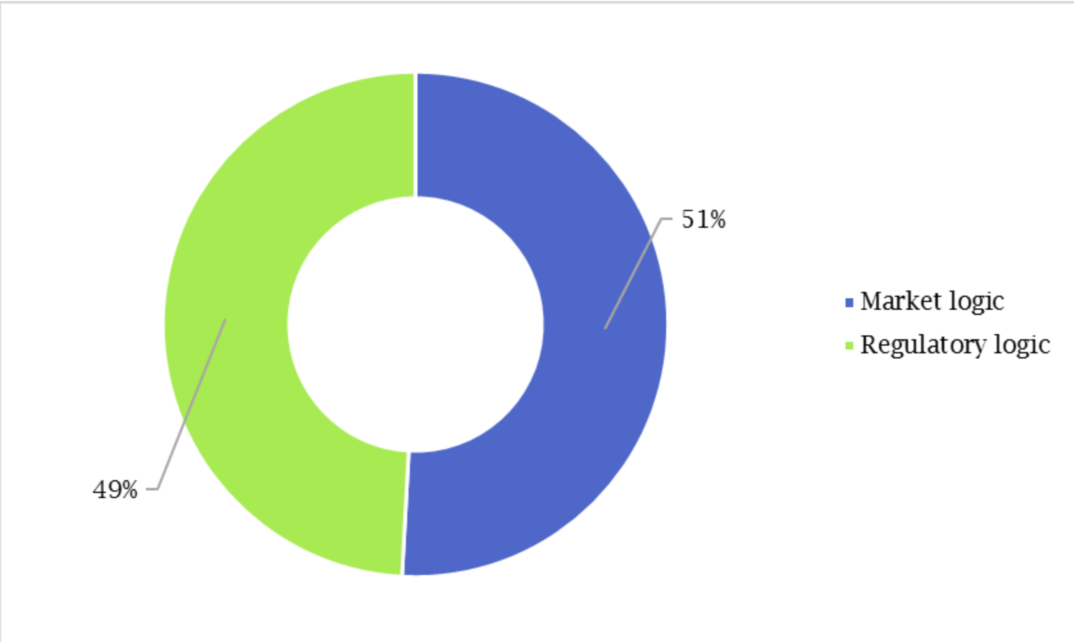
> *'The continuing absence of clarity around areas such as the transition to the Liquidity Coverage Ratio ('LCR') and capital requirements leaves us with little alternative but to move ahead with our own interpretation in many areas or risk finding ourselves with too short a timeframe for implementation' (Standard Chartered, 2013b, p. 1)*

Without clear understandings or interpretations of the proposed rules, as the quote from Standard Chartered indicates, the banks claimed it was difficult to formulate an appropriate response either in terms of practical implementation or for the 'further management actions' (Barclays, 2010a, p. 168) necessary to mitigate increases in capital requirements. So, instead of the emphasis of the state and effect uncertainty perceived by banks in Phase 2, Phase 3 can be characterized more in terms of response uncertainty, a 'lack of knowledge of response options and/or an inability to predict the likely consequences of a response choice' (Milliken, 1987, p. 137).

Accounting for these variations

Whilst the overall use of market and regulatory logics by banks to discuss regulatory change over the entirety of the discourse analysis period was very evenly split (see Figure 4.7), the above discussion shows that there were significant variations over time. The literature on organizational responses to institutional pressures and multiple institutional logics is instructive in attempting to account for these variations.

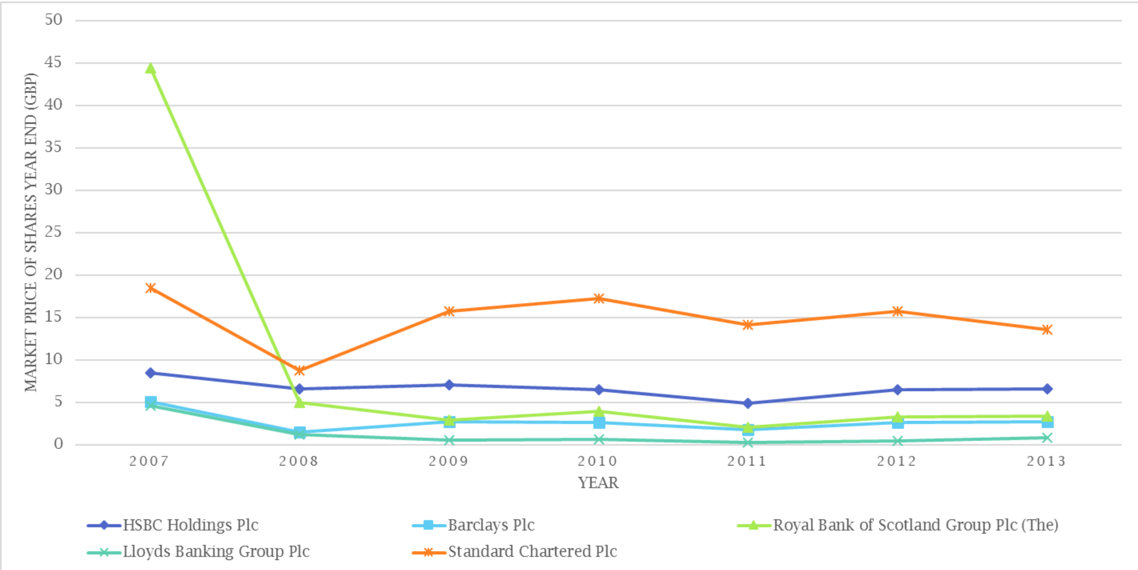
Figure 4.7 Market vs regulatory logic 2006 -2013



Source: Bank annual reports and consultation responses

In Phase 1, the low level of overall discussion of regulatory change suggests that regulation was not a key concern for the banks during this period. This is perhaps indicative of the close alignment of the institutional orders of the market and regulation at this time. Indeed, the BCBS explicitly stated that the aims of Basel 2 rules was not to increase the quantum of capital in the financial system but to ensure the distribution was more risk-sensitive (BCBS, 2004, p. 4). For large, internationally active banks that were most likely to adopt the advanced calculation approaches, minimum capital requirements were forecast to fall by about 7% (BCBS, 2005, p. 10). There was, therefore, no regulatory threat to the profitability or financial performance of the banks and adopting a strategy of acquiescent compliance (Oliver, 1991) in response was understandable. The political pressures on regulators to be non-interventionist (see Chapter 3) also suggests that the market was a more dominant source of legitimacy for banks prior to the crisis measured by high share prices (see Figure 4.8) and Returns on Equity of over 15% (Oliver Wyman, 2014)

Figure 4.8 Market price of shares for five sample banks 2007-2013



Source: Bankscope

Conflict between market and regulatory logic began to emerge after the crisis, during Phase 2. As Chapter 3 discussed, the dominant narratives about the social value of banking and the ability of the market to discipline itself had been undermined by the events of 2007-8 (Engelen et al., 2012). The cognitive underpinnings of prudential regulation had also shifted. In addition, the legitimacy of the banking industry had been severely damaged, not just in terms of the regulators (Financial Services Authority, 2009e) but also the general public (Bennett & Kottasz, 2012; Edelman, 2009) and even shareholders. In the case of the latter, the legitimacy criteria associated with the market suggests that legitimacy is connected with the value of an organization's shares and the possible returns for its shareholders. Figure 4.8 shows that the share prices of all five sample banks fell between 2007 and 2008 and, except for Standard Chartered, continued to decline until 2011.

The increased deployment of market logic, particularly in bank annual reports, may well have been an effort to pacify one legitimacy community – shareholders – by appearing to challenge regulatory objectives which could further damage profitability and therefore shareholder returns. Certainly, some of the rhetoric employed by banks, particularly in the CEO statements of the annual reports support this position. More broadly, however, in their examination of the elite narratives that emerged after the financial crisis Engelen et al. (2012) claim that 'financial elites remained remarkably resilient and politically effective in defending the status quo' (p159). This account cites two reports written by prominent city grandees[59]. Both of these reports (Bischoff & Darling, 2009; Wigley, 2008) emphasized the importance of the financial services industry to the UK economy and were seen as an attempt to 'head off reform by repeating and updating their pre-crisis story about the social contribution of finance' (Engelen et al., 2012, p. 179). For example, the Wigley report argued that new regulation could pose a number of 'threats':

> *'One threat is that ill-conceived regulation could be rushed through. Another is that new regulation overcompensates for possible gaps in pre-crisis regulation, putting in place unduly restrictive rules which stifle enterprise' (Wigley, 2008, p. 24)*

With such narratives being deployed more broadly, and even informing political responses[60], perhaps banks believed they still occupied a position of political power and were in a position to influence the trajectory of reform.

[59] Sir Win Bischoff, former chairman of Lloyds Bank and Bob Wigley, who had been the chairman of Merrill Lynch in Europe, the Middle East and Africa until 2009

[60] Engelen et al. (2012, p. 180) explain how parts of the Bischoff report were directly cut and pasted into the Labour Government's white paper in response to the financial crisis (HM Treasury, 2009).

The consultation responses revealed a more nuanced use of market logic as banks did engage in attempts to negotiate and influence the details of the regulatory rules. This is redolent of the response strategy of 'bargaining', suggested by Oliver (1991), described as 'the effort of the organization to exact some concessions from an external constituent in its demands or expectations' (p154). This is indicative that banks were not just considering their legitimacy but also their interests with respect to regulatory changes.

Another possibility for the bank's reversion to the use of market logic immediately after the financial crisis might relate to the high degree of uncertainty about the future direction of regulation, particularly in terms of the possible impacts on future profitability. The aim of Basel 3 was explicitly to increase bank capital levels, which some commentators also argued would affect profitability (Fitch Ratings, 2012; McKinsey & Co, 2010). However, this was by no means certain, and neither was the argument that higher capital requirements would damage economic recovery or have a commensurate impact on credit creation (Admati et al., 2011; Allen et al., 2012; Caruana, 2010; Miles et al., 2013; Yan et al., 2012). Oliver (1991) suggests that a high degree of environmental uncertainty would prompt an organization to 'exert greater effort to re-establish the illusion or reality of control and stability over future organizational outcomes' (p170). It may be the case then that rather than acknowledging the indeterminacy of the debate between shareholder returns versus financial stability, banks were sticking with their established view, one which had previously had significantly wider legitimacy.

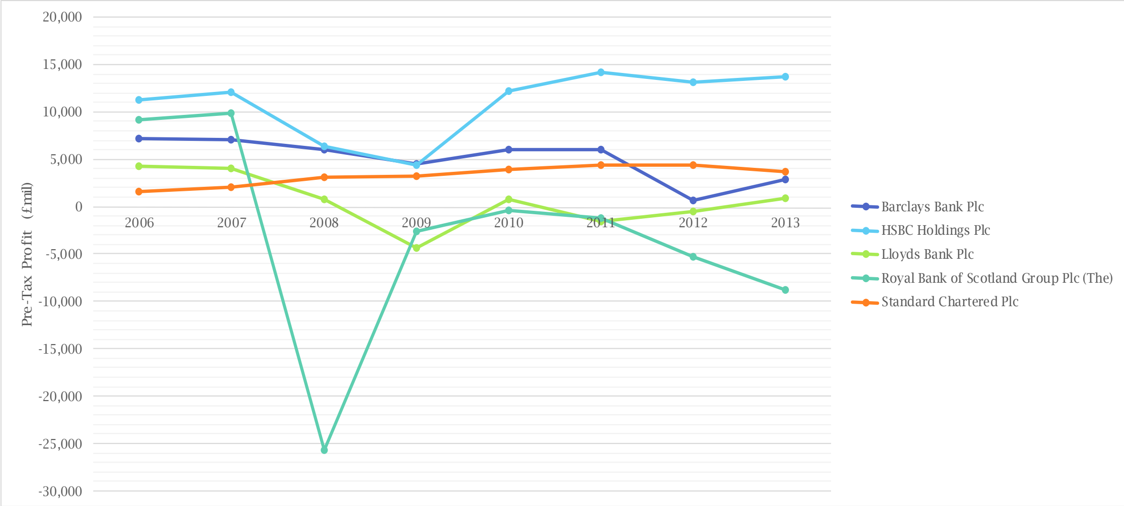
The balance between the use of regulatory versus market logic shifted in the final phase, with a marked increase in the use of regulatory logic. Four possible explanations for this are offered here. The first is that the nature of the uncertainty relating to the regulatory proposals changed. As discussed above, this phase was characterized by a shift from legislation to implementation, which required banks to make decisions about their future actions. Thus, the discourse was more focused on banks trying to clarify the substantive details of the rules. Secondly, there is the possibility that there was a time lag between banks recognizing that their previous, market logic based arguments were no longer legitimate, and the reduction in the use of this logic in discussions about regulatory change. This would certainly help to explain the steep drop in the use of market logic from 2010 to 2011 when shareholders were no longer their key source of legitimacy.

Thirdly, banks were experiencing the changing nature of the supervisory relationship between the banks and the FSA at this time as demonstrated by the FSA Practitioner Panel's 2010 survey. In this survey, larger firms indicated a more intrusive supervisory approach was 'evident through more dialogue with the FSA, a greater amount of information requests that were clearly scrutinized in greater detail thank in the past, and a more intrusive attitude of supervision teams' (FSA Practitioner Panel, 2011, p. 76). The banks, therefore, may have been receiving signals from their supervisors that raising strong objections to regulatory reforms was not appropriate. Without further research, however, this reasoning remains speculative. Finally, as noted above, several financial scandals were revealed during this period of time, resulting in all five of the large UK banks being fined large amounts by both UK and US regulators (Conduct Costs Project, 2015). These fines were not related to prudential regulation, but did have direct impact on bank profitability (KPMG, 2013) and therefore expected shareholder returns. Added to this the likely reputational impact of regulatory sanctions on the share price (Armour, Mayer, & Polo, 2010), expressing overly defiant or negative views about regulation would have been deemed illegitimate at this time, even according to the legitimacy criteria of market logic.

Variations in institutional logics between sample banks

The impact of the financial crisis on the five banks in the sample varied significantly. In some cases, such as HSBC and Barclays, they weathered the storm without requiring direct state intervention. In others, such as RBS and HBOS (which merged with Lloyds as part of the rescue package), the events of 2008 required the government to intervene to save these banks from insolvency. This culminated in the state exchanging some £80bn of taxpayers' money for a 41% stake in Lloyds and an 83% stake in RBS (National Audit Office, 2009). All the banks suffered some immediate reductions in profitability, but over time some fared better than others. This is represented in Figure 4.9.

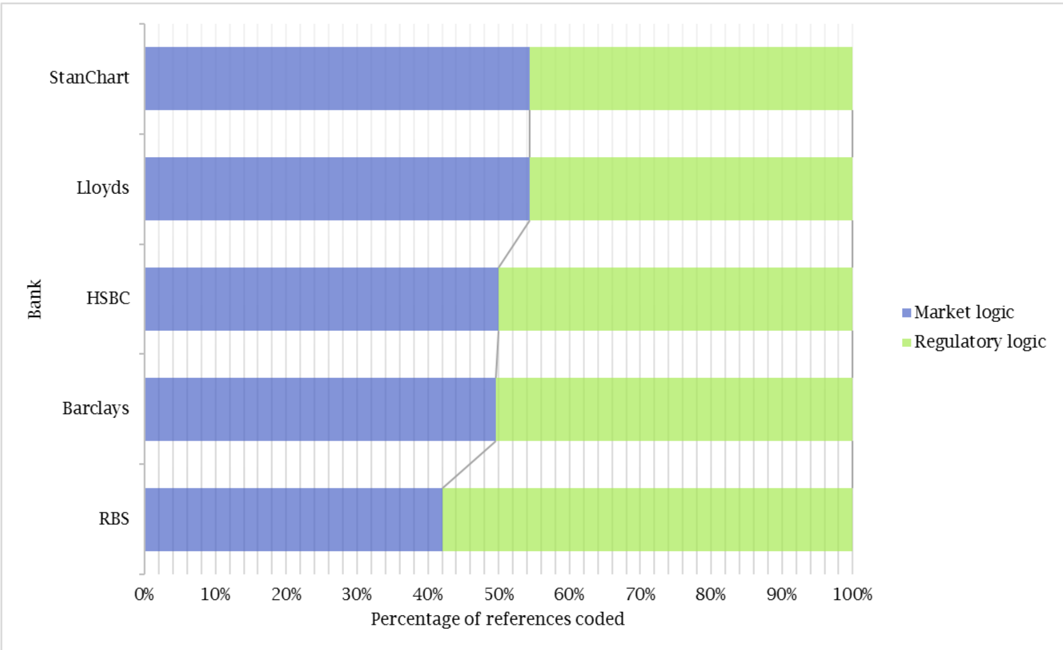
Figure 4.9 UK banks pre-tax profit 2006 – 2013



Source: Bankscope

Given this variety of experience over this timeframe, it would be reasonable to expect some differentiation between the banks in how they used discursive devices associated with market and regulatory logics to shape their publicly-stated responses to regulatory change.

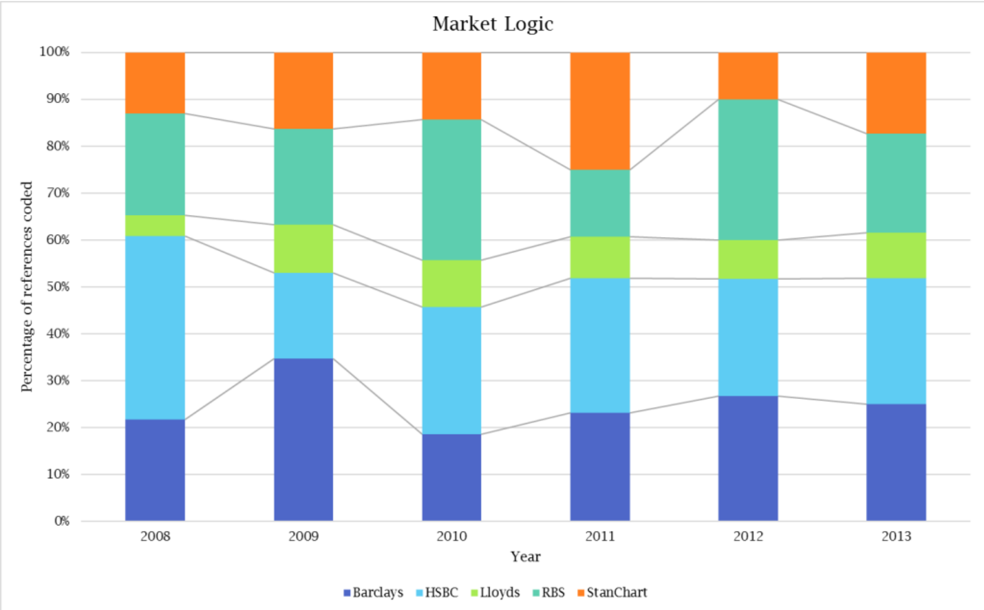
Figure 4.10 Aggregate use of institutional logics by sample banks 2006 - 2013

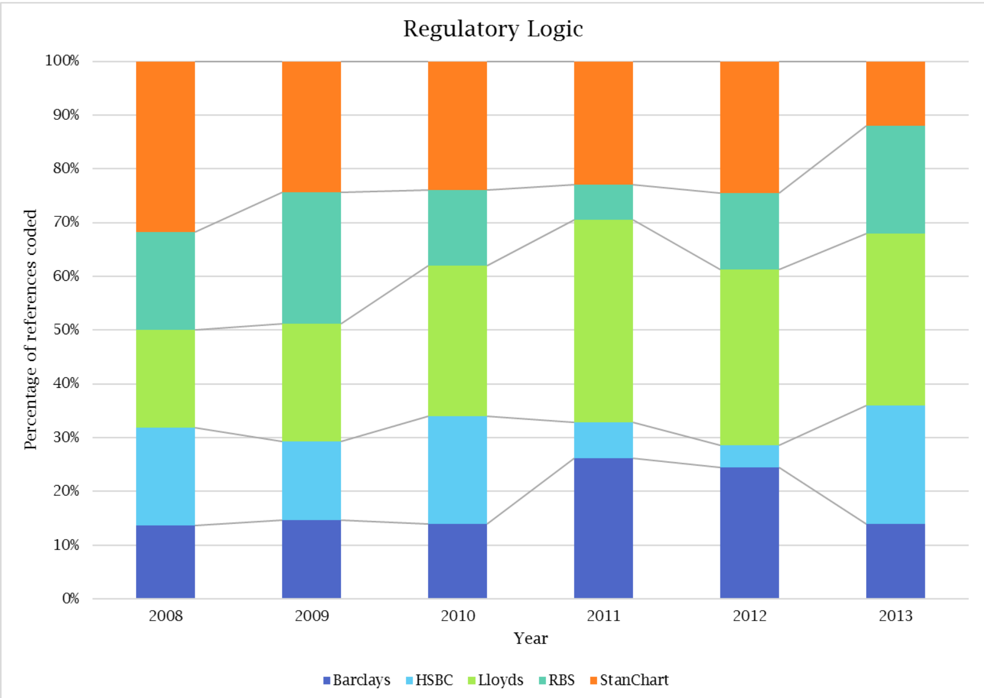


Source: Bank annual reports and regulatory consultation responses

The aggregate picture of the use of the two institutional logics for this time period is shown in Figure 4.10. RBS has the highest overall percentage (58%) of textual items coded to regulatory logic whereas Standard Chartered has the most coded to market logic (54%). These are not marked differences and overall, it seems as if there is a relatively consistent split between the use of market and regulatory logic for all five banks. What this aggregate picture does not show, however, is how the banks' mobilization of the logics varied over time which is shown in Figure 4.11.

Figure 4.11 Variation in use of market and regulatory logics 2008-2013





Source: Bank annual reports and regulatory consultation responses

The theoretical work on organizations and responses to changes in their institutional environments discussed in Chapter 1 suggested several factors that can account for this variation in responses (Greenwood et al., 2011; Oliver, 1991; Pache & Santos, 2010). These include the types of institutional demands being made and how these demands are represented internally within the organization (Pache & Santos, 2010), the structure of an organizational field and the specific characteristics of the organization such as its organizational identity, its ownership, governance and structure, and its position in the organizational field (Greenwood et al., 2011). Table 4.3 illustrates some of the key characteristics of the five UK banks in the sample. It is possible to draw some tentative associations between these characteristics and the use of the institutional logics by these organizations over time.

Table 4.3 Characteristics of five sample banks

Bank	Total Assets (£m)	Total Employees	Key Markets	Customers	State Help
Barclays	1,344,201	140,300	UK Europe Africa & Middle East Americas Asia	Retail Commercial Wholesale	No
HSBC	1,622,024	263,000	UK Europe Hong Kong Rest of Asia-Pacific Middle East & North Africa North America Latin America	Retail Commercial Wholesale	No
Lloyds	857,354	97,869	UK	Retail Commercial	Yes
RBS	1,027,878	118,600	UK Europe Middle East Americas Asia	Retail Commercial Wholesale	Yes
Standard Chartered	409,484	86,640	Asia Africa Middle East	Retail Commercial Wholesale	No

Source: Bankscope, Annual Reports (as at end 2013)

Perhaps the most obvious characteristic to highlight is how the use of regulatory and market logic differed between the banks that were rescued by the state during the crisis

(RBS and Lloyds) and those that were not (Barclays, HSBC and Standard Chartered). The receipt of taxpayers' money meant that the bailed out banks faced increased scrutiny of their organizational legitimacy from the public and the government. Deephouse (1996) contends that two sets of social actors are important sources of legitimacy for banking organizations – regulators and the public. It would follow that the bailed-out banks would make increasing use of regulatory logic in the wake of the crisis to help repair their legitimacy.

Figure 4.12 Comparison of use of market and regulatory logics: state aid vs. no state aid 2008-2013

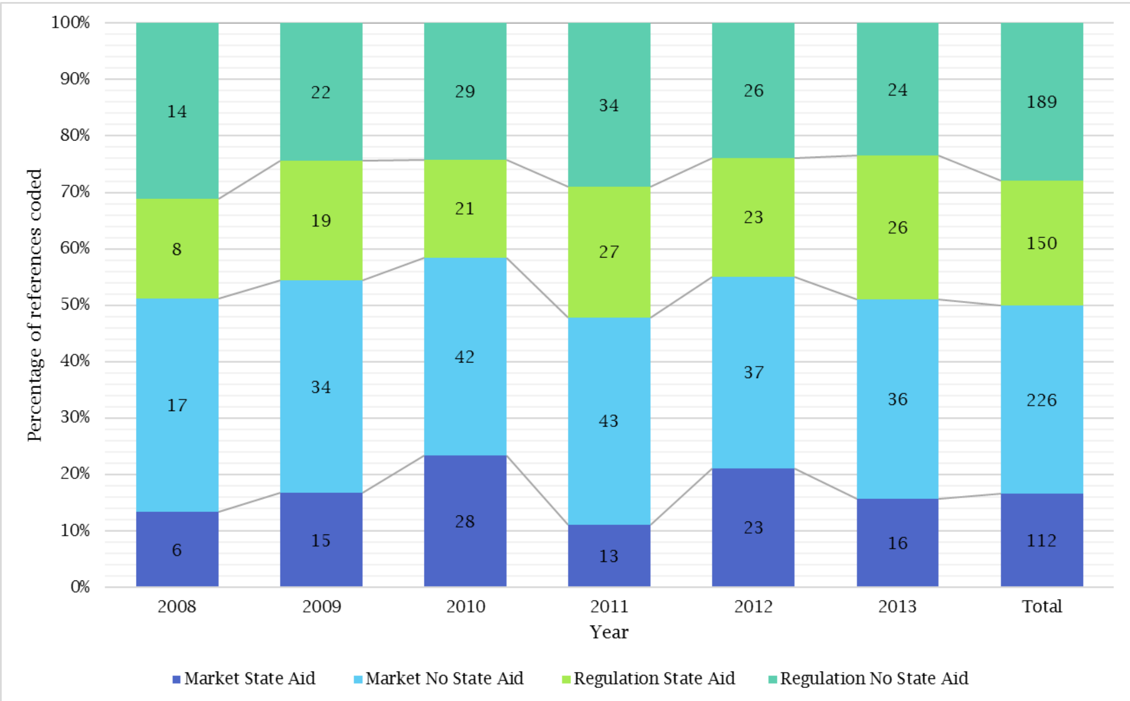
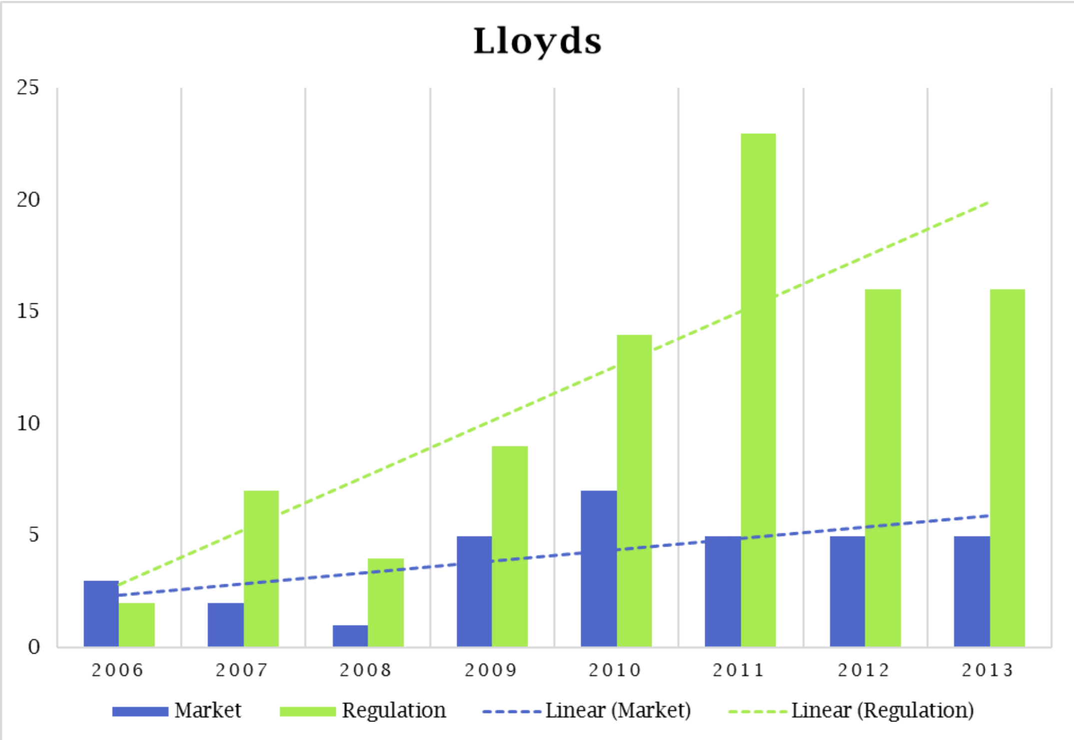
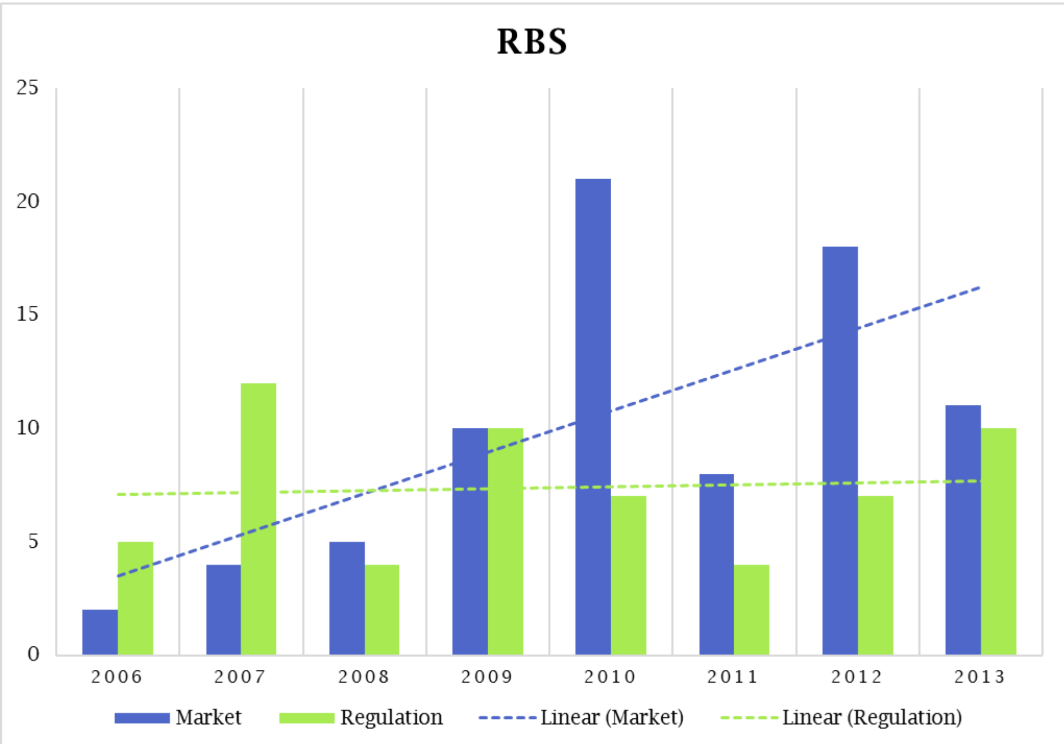


Figure 4.12 shows a comparison of the use of institutional logics between banks that received state aid and those that did not. It shows that comparatively, RBS and Lloyds together tended to mobilize regulatory logic more than their non-bailed out peers, who used a greater relative proportion of market logic. However, when this data is disaggregated further, as in Figure 4.13, RBS appears to respond to regulatory change using the logic of the market far more frequently than Lloyds, especially in 2010 where the use of market logic across all the banks was at its peak.

Figure 4.13 Comparison of Lloyds' and RBS' use of market and regulatory logic 2006 - 2013





Source: Bank Annual Reports and regulatory consultation responses

This increased use of market logic by RBS is surprising, given the level of media and public anger directed towards RBS after the bail out and subsequent events, including the announcement of large bonuses and pensions for senior executives such as Fred Goodwin (Edwards, Gammell, Allen, & Bingham, 2009; Fraser, 2014; Griffiths, 2009; Treanor, 2010). The organizational literature suggests that this damage to RBS's reputation and legitimacy would provoke RBS to engage in significant legitimacy repair work (Suchman, 1995) rather than revert to the type of discourse that is associated with the bank's near collapse. One possible explanation for this is that those in RBS were either in denial or did not understand the harm caused by its near collapse and subsequent bail-out. Institutional theory suggests an alternative possibility, that 'when institutions are in conflict, people may mobilize to defend the symbols and practices of one institution from the implications of changes in others' (Friedland & Alford, 1991, p. 255). In this case, perhaps RBS was mobilizing the frames and narratives of market logic which had previously been dominant within this bank as part of its expansionist philosophy under the leadership of Fred Goodwin (Fraser, 2014) even though he was no longer the CEO in 2010.

Greenwood et al. (2011) also suggest that an organization's position within an organizational field can determine how it will respond to complex institutional pressures. A distinction is made between 'core' and 'peripheral' organizations depending on their size and status, with larger and more powerful organizations being central and smaller and lower status firms occupying the periphery. The banks in the discourse analysis sample were the top five banks in the UK by asset size but there was some variation in their field positions not only in terms of size but also where the banks operated. HSBC, for example, was the largest bank by asset size and was the most prolific user of market logic between 2008 and 2013. Greenwood et al. (2011) contend that 'to the extent that [institutional] complexity threatens the advantageous position of central organizations, they will be increasingly resistant to it' (Greenwood et al., 2011, p. 340). HSBC perceived itself as central in the UK banking market, which is apparent in the repeated threats issued by this organization to move its headquarters to Hong Kong in response to government policies that it considered punitive (BBC, 2010; Turner, 2015). Thus, a stance of resistance might account for HSBC's persistent use of market logic in discussing regulatory change. This may have been further compounded by the management of HSBC considering their bank's perceived importance to the UK economy meant it was somewhat immune to the pressures of regulatory changes. Based on this understanding, HSBC would be therefore granted a measure of discretion in how to respond to regulatory reform, with the use of market logic not necessarily viewed as illegitimate by other external constituencies such as politicians or regulators (Greenwood et al., 2011).

Whilst none of these five banks were peripheral in terms of size, Standard Chartered was geographically peripheral as the majority of this firm's operations were located outside the UK, primarily in Asia, Africa and the Middle East. Drawing once again on the arguments made by institutional theorists, organizations occupying a peripheral field location may not experience institutional pressures to the same degree as those in the core and are less likely to be advantaged by the institutional status quo (Greenwood et al., 2011). This could potentially account for Standard Chartered consistently using regulatory logic more than market logic in discussions of regulatory change in the UK – its position in the market is not under the same degree of pressure as the other four banks. These conclusions are necessarily speculative, given the qualitative and interpretive nature of the research methodology. The discourse analysis data did not allow exploration of other factors that might influence how organizations respond to complex institutional change such as organization structures and organizational identity (see Chapters 5 and 6 respectively). What is clear, however, is that responses differ between organizations, and this might be due to their pre-existing characteristics which act as filters so that different organizations mobilize market and regulatory logics in different ways to shape their public responses (Pache & Santos, 2010).

Discussion

The preceding analysis has shown that whilst the balance between the use of market and regulatory logics did vary over time and between different banks, nonetheless, these banks were mobilizing arguments using both logics simultaneously. What this indicates, perhaps, is a recognition on behalf of the banks that they were expected to both continue to deliver (or improve) returns to shareholders at the same time as complying with the requirements for increased capital. Banks had to manage these conflicting demands to remain legitimate in both the eyes of the market and the regulators. The findings of the discourse analysis are suggestive of three factors that might affect the balance between the use of market and regulatory logic in how banks publicly frame their responses to prudential regulatory change – the degree and type of the associated uncertainty, the position of the organization in the organizational field and the nature of the regulatory regime itself.

From 2009 to 2010, there was a significant peak in the use of market logic. This time frame also coincided with the release of the majority of new regulatory proposals from the BCBS and the EU and in the UK, the change in government and proposed reform of the financial regulatory regime. In addition, as discussed above, the established narrative orthodoxy about the social value of banking and how the financial system should be regulated had been undermined. This period of time represented the peak of both state and effect uncertainty (Milliken, 1987) in the aftermath of the financial crisis. Whilst a causal relationship cannot be asserted given the data and methodological approach of this study, it is possible to surmise that the use of market logic may reflect the level and type of uncertainty in the regulatory environment. Once there is more certainty, the use of regulatory logic increases, particularly as the rules become closer to being finalized and there is enough information for the banks to understand the potential impacts on both their finances and operations. So, the degree and nature of uncertainty in the environment appeared to have a bearing on how banks represented their views on regulatory change using institutional logics.

Secondly, there were clear differences in how the five banks in the sample articulated their public responses to regulatory change. Again, whilst relationships between organizational characteristics and the use of either market or regulatory logic cannot be confirmed, the data is suggestive of there being some link between the ownership of the bank or its position in the organizational field and how institutional logics are mobilized in discussions of regulatory change. In terms of bank ownership, the relationship between state ownership and the use of market logic by RBS is perhaps contrary to expectations. Whilst Lloyds Bank did indeed make greater use of regulatory logic in the aftermath of the financial crisis, RBS, which was by then 83% government owned, increasingly used market logic to comment about the adverse impacts of the new regulations. This was perhaps an attempt to compromise or negotiate from a distance with the regulatory standard setters to reduce the stringency of the new capital requirements and/or to emphasize to their investors the potential impacts of the policy-makers' decisions. The hypothesis here is that when institutional logics come into conflict, organizations might amplify their use of the previously dominant logic (market logic in this case) if they perceive it as being under threat. Another bank which made extensive use of market logic was HSBC, the largest bank in the UK and one which believed it held a powerful position in the UK economy, demonstrated by its continual threats to relocate its headquarters to Hong Kong. This accords with the contention that an organization's position in the core of a particular organizational field will have a bearing on how it responds to multiple institutional demands. It could be argued, meanwhile, that Standard Chartered occupied a more peripheral location and consequently, there was less at stake financially and therefore there was less imperative to defend the institutional logic of the market. Whilst the organizational factors identified above do have some explanatory power, it is important not to lose sight of the fact that banks were mobilizing arguments using both logics simultaneously.

The third contention is that prudential regulation affects the core of a bank's business and can have a fundamental impact on its profitability[61]. Prudential regulatory rules are complex and contain many quantitative controls that can be altered individually or in concert (and at the request of the regulator) to alter the minimum capital requirements or liquidity ratios of the bank[62], and thus directly impacting the financial position of the firm. As a result, this type of regulation has the potential to directly influence the

[61] Prudential regulation is not alone in having such a profound effect on a company's balance sheet – regulatory techniques such as the setting of price controls in the energy sector is another example of how regulation can penetrate to the core of a firm's business.
[62] Examples include various multipliers which are applied to risk weighted asset numbers, the capital add-ons under Pillar 2 (which are purely at the regulator's discretion), the correlation factors within the capital calculations and the regulatory floors for particular risk measures.

generation of shareholder returns, profitability, position in the market, decisions about funding and even banks' business models. It is feasible to suppose that in mobilizing the logic of the market, banks are responding to this perceived threat to their financial survival. Indeed, the rhetorical strategies that have been highlighted in this chapter resonate with the types of 'institutional work' that Lawrence and Suddaby (2006) associate with the maintenance of institutions. For example, by 'borrowing' societal narratives about the social value of banks in statements such as 'Barclays recognizes the vital economic and social purpose that banks play' (Barclays, 2009, p. 6) banks were 'valourizing' the role of their organizations for public consumption. Similarly, arguments about the need to balance financial stability with economic growth is an appeal to past beliefs and myths about the importance of the banking system to the economy. So, whilst at first glance, these types of discursive device seemed at odds with the actual harm caused by the credit crisis, they can be viewed as a particular type of response to a particular type of regulation, which targets the very core functions of a bank.

This chapter is not making a normative distinction between the use of market logic and regulatory logic and nor is it claiming that an organization which uses regulatory logic more frequently to discuss regulatory change is more likely to agree or become compliant with those changes. Indeed, Meyer and Rowan (1977) suggest that where conflicts arise in an organization's institutional environment, organizations will appear to comply with institutional demands by decoupling formal structures and practices from the technical core of their operations. In terms of regulation, this response would be one of ceremonial compliance only, with no substantive alteration to day-to-day business practices. It is not possible to explore how substantively banks have responded to regulatory change by examining their public texts, which project a particular organizational self and message externally. Instead, the next three chapters make use of interview data from several banking organizations (which differ from those selected for the analysis in this chapter) to investigate in greater depth the more material and concrete responses to regulatory change that have occurred since the financial crisis, beginning with the practices and structures that have been put in place to manage the process of regulatory change itself.

Chapter 5: Organizational encounters with the risks of regulatory change

In 2013, a survey of European financial institutions found that 91% of Risk Managers considered regulatory change to be the biggest risk that they faced (Strategic Risk, 2014). This categorization of regulatory change as a risk to be managed by the financial industry is in part a response to the uncertainty created by the changing regulatory environment – uncertainty about the nature of the reforms, the impacts of the changes and how to adapt to the changes. However, it is also indicative of the fundamental threats that the changes in the prudential regulatory regime were perceived to pose to the banks' business models and profitability (Ernst & Young, 2013; Masters, Jenkins, & Guerrera, 2010; McKinsey & Co, 2010; Ötker-Robe et al., 2010). Moreover, as Chapter 4 demonstrated, incidents of regulatory non-compliance negatively impacted the legitimacy of the banking industry and incurred significant costs (Conduct Costs Project, 2015). There were, therefore, multiple risks associated with regulatory change, and this chapter explores the structures and practices that five banking organizations in the UK put in place to manage – and balance - these different risks.

Structures and practices are regarded by the institutional logics perspective as the concrete manifestations of institutional logics and 'while practices are guided by existing institutional logics, as existing practices are altered or new ones are established, they place a key role as exemplars in creating, reproducing and transforming institutional logics' (Thornton et al., 2012, p. 129). Following the so-called 'practice turn' in social sciences (Ortner, 1984; Reckwitz, 2002; Schatzki et al., 2001), Thornton et al conceive of practices as 'constellations of socially meaningful activity that are relatively coherent and established' (Thornton et al., 2012, p. 128).

When considering the management of the risks engendered by regulatory change, using the institutional logics of regulation and the market developed from the discourse analysis in Chapter 4 can be instructive. On the one hand, viewed through the lens of market logic, the prospect of adverse financial consequences resulting from the new regulations such as reductions in profitability and therefore lower shareholder returns would take priority in terms of managing the risks of regulatory change. Considered from the perspective of regulatory logic, however, where rule compliance is regarded as a key organizational priority of management, managing the risks of non-compliance would take precedence. As Chapter 4 showed, in line with institutional scholars who emphasize the pluralistic nature of an organization's institutional environment (Greenwood et al., 2010; Greenwood et al., 2011; Kraatz & Block, 2008; Pache & Santos, 2010, 2012), banks were publicly responding to the conflicting institutional pressures of their environment by adjusting their use of market and regulatory logics over time. This suggests that the management of the risks of regulatory change within an organization over this period were also subject to similar conflicts and tensions, requiring decisions to be made about which types of regulatory risk will command the most organizational attention.

Chapter 4 only focused on banks' external, symbolic representations of their views on regulatory change. As noted in that chapter, no conclusions could be drawn about the substantive nature of any internal organizational changes they may have been making in response to the regulatory reforms. However, the intention of the analysis in this chapter is to move the focus inside the banks by using data collected in 22 interviews with respondents from five different organizations. As explained in Chapter 2, the data here does not come from the same banks whose public statements were analyzed in Chapter 4. The chapter explores in greater depth how the risks of regulatory change are managed and the practices and structures that banks have put in place to do so. It is here that substantive adaptations to regulatory change are more likely to occur, but as the analysis in this chapter shows, it is not always clear which risks of regulatory change these practices and structures are aimed at mitigating. The discussion begins by briefly describing the types of structures and practices that emerged from the data and maps these on to a view of regulation as a dynamic process or lifecycle[63]. Then, these practices

[63] In analysing the interviews, it was clear in some cases that new structures and practices had been introduced since 2008 but it was not clear precisely when. In other instances, the regulatory practices and structures were still evolving. Thus, the interview data presents a snapshot in time of how the sample banks were organized for managing regulatory change and the ability to make comparisons to previous periods of time (such as before the financial crisis) is therefore limited.

and structures are considered from the perspective that banks' view regulatory change as a risk to be managed using Hutter and Power's metaphor of 'organizational encounters with risk' (Hutter & Power, 2005). The chapter concludes with the insights that this analysis has for the broader understanding of how banks manage regulatory change.

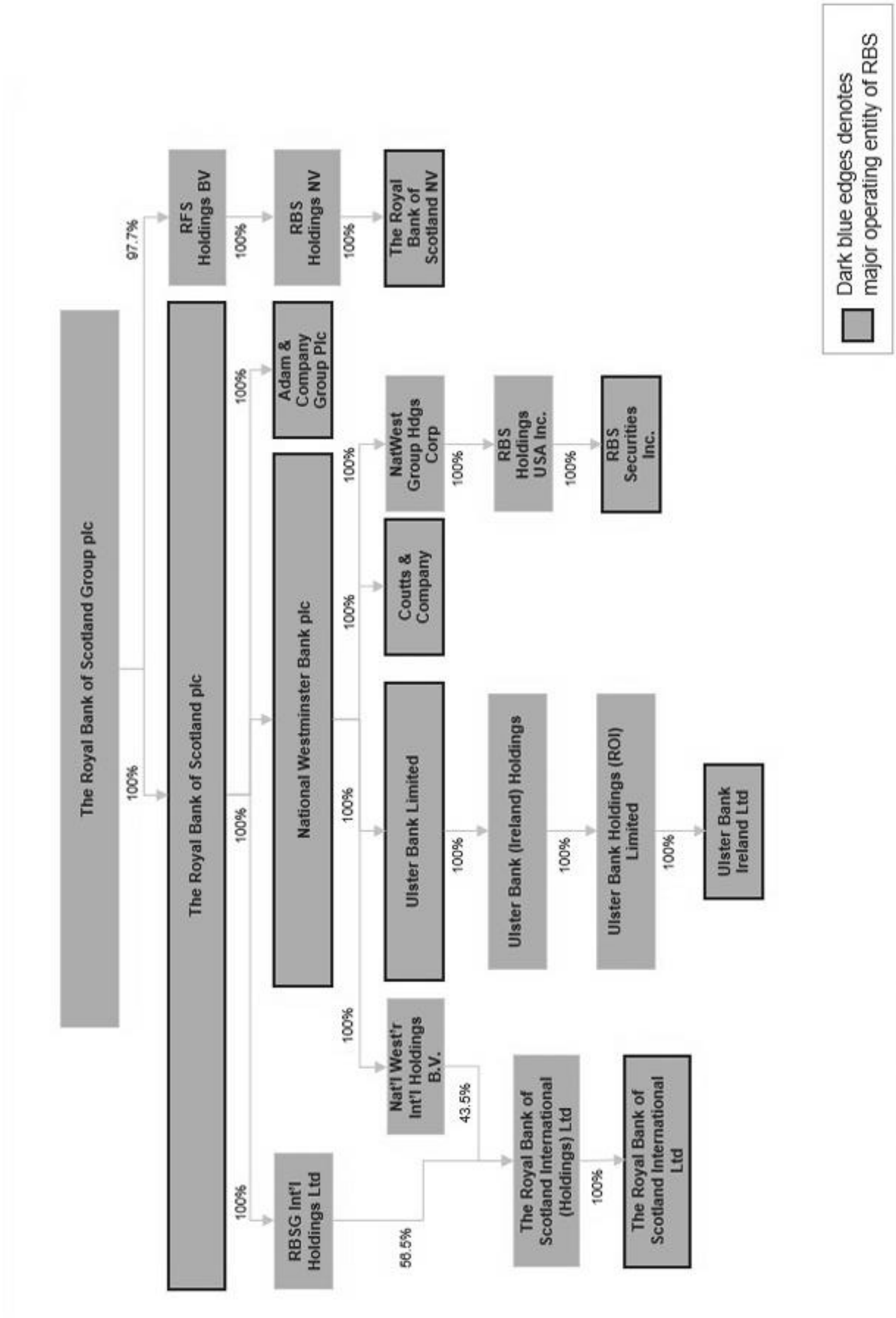
Managing regulatory change – structures and practices

Structures

Large, internationally active banks have complex structures. They operate in many different jurisdictions and have different business units. For example, as of 2013, Barclays Bank operated in over 50 countries and had seven separate business lines (Barclays, 2013, p. 3). Similarly, HSBC was located in 75 countries, with four separate business areas (HSBC, 2013, p. 1). An additional layer of complexity results from the legal entity structure of these large banks, a hierarchy of the separate companies that comprise the whole organization. An example of such a structure for the Royal Bank of Scotland is shown below in Figure 5.1. It is on the legal entity basis that banks are authorized and supervised, and the nature of the legal entity determines how accounting and prudential regulatory reporting must be performed for that company.

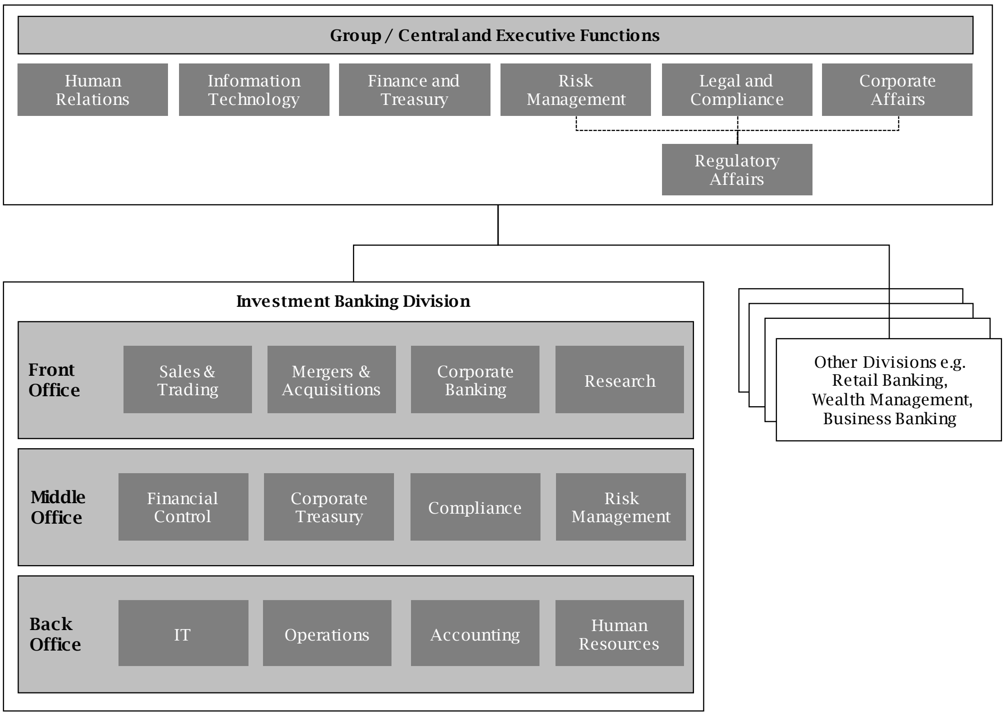
However, the day-to-day operational and management structure of a large banking organization often cuts across legal entity boundaries and is more usually based on the separate business lines of the bank. Figure 5.2 depicts a generic bank organizational structure. This is for illustrative purposes only, and is drawn from a combination of information from bank annual reports and interview data. All the banks in both the discourse analysis and interview samples were organized slightly differently based on the degree of centralization of management, whether the bank's entity in the UK was a subsidiary or the main headquarters, and the nature of the business areas and customers or clients.

Figure 5.1 RBS legal entity structure as of 2015



Source: http://investors.rbs.com/fixed-income-investors/company-legal-structure.aspx

Figure 5.2 Generic structure of a large, internationally active bank



Source: Bank Annual Reports, interview data

Figure 5.2 shows that the business units are overseen by a set of central functions, which are sometimes also replicated within the business unit depending on its size (such as Finance, Human Resources, Information Technology and Risk Management). The size and responsibilities of the central functions will depend on how much management power has been devolved to the business units. Given the focus of this study was on wholesale rather than retail or wealth management banking, a more detailed view of a generic Investment Banking division is also shown in Figure 5.2. Typically, investment banking divisions are described in terms of three layers – Front Office, Middle Office and Back Office (Ho, 2009, pp. 37-38). The Front Office consists of the revenue-generating parts of the business, such as securities selling and trading, the provision of mergers and acquisition advice, banking services for large corporations and research by investment analysts. The Middle Office comprises the control functions that support the Front Office such as Risk Management and Compliance. Finally, operational support functions such as Accounting and Human Resources and the processing that is required to support trading and sales activities constitute the Back Office. Ho (2009) describes how these three layers operate in a hierarchy, segregated not only spatially but also in terms of compensation and social background. Typically, in investment banks, the Front Office, being at the 'top' of this hierarchy also wields the greatest organizational power, authority and status.

The diagram illustrates that the positioning of the Regulatory Affairs department can vary between banks. This is the department which has primary responsibility for liaison with all the banks' regulators[64] and might also be called the Regulatory Liaison Office or Regulatory Relations (Deloitte Centre for Regulatory Strategies, 2013). Depending on how the bank is structured, this department may report to Risk Management (and thus the Chief Risk Officer), Legal and Compliance (the Chief Compliance Officer) or even Corporate Affairs.

Table 5.1 shows the organizational positions of the interview respondents, five of whom were located within a Regulatory Affairs department.

Table 5.1 Organizational position of interview respondents

Area	Group	Division / Region†	Total
Risk Management	4	5	9
Regulatory Affairs	4	1	5
Corporate Affairs	2		2
Finance	4	2	6

† *Region indicates that an interview respondent had a regional rather than divisional role*

At the time of the fieldwork interviews (2013 – 2014), in Bank 1, Regulatory Affairs was in the process of being created as a separate function, with the Head of the Department reporting directly to the CEO. Regulatory Affairs was also a distinct department in Bank 4. In Bank 2, Regulatory Affairs was part of the Legal and Compliance department. Bank 3 had a dedicated Regulatory Affairs team for prudential regulation, which was located within the Finance function. In Bank 5, the responsibilities for Regulatory Affairs were split between Corporate Affairs and Legal and Compliance, with the former focusing on

[64] This will include both prudential and conduct regulators as well as the regulatory authorities in the overseas jurisdictions where the bank also has operations.

monitoring regulatory changes and the latter managing the liaison with the regulators and the monitoring of ongoing compliance.

Figure 5.3 represents an ideal-typical view of the regulatory process, consisting of three chronological stages. The first stage is the development of new regulations by the regulators, standard setters and policy-makers. In the context of this thesis, this roughly corresponds to the period immediately after the financial crisis (2009 – 2011) when the bulk of the new proposals were created. The second stage in the regulatory lifecycle is the finalization of the rules and the confirmation of implementation dates by the regulators. The implementation stage was underway at the time of the interview fieldwork. Finally, the third stage occurs when the regulations are legally enforced and is characterized by the ongoing monitoring of organizational compliance. In the case of Basel 3, the final implementation date was scheduled for the end of 2019 (see Chapter 3). From the interview data, it was clear that organizational responsibilities for regulation varied in accordance with this lifecycle. Figure 5.3 also represents a composite view of how regulation was organized across the five banks in the interview sample, and how this differed between conduct and prudential regulation.

During the first stage of the regulatory lifecycle, the Regulatory Affairs department generally had the formal responsibility for monitoring changes on the regulatory horizon for both conduct and prudential regulation. However, discussions with interviewees from Risk Management and Finance[65] areas suggested that whilst they were not formally required to keep track of regulatory developments, they felt it was necessary for them do so informally. This was primarily because these areas had the technical expertise to makes sense of the changes and felt they needed to engage with them as soon as possible.

The responsibilities for making the requisite changes involved a combination of actors from risk management, finance and other organizational areas affected by the new rules. In some instances, (such as Banks 1 and 2), dedicated teams of project managers, risk

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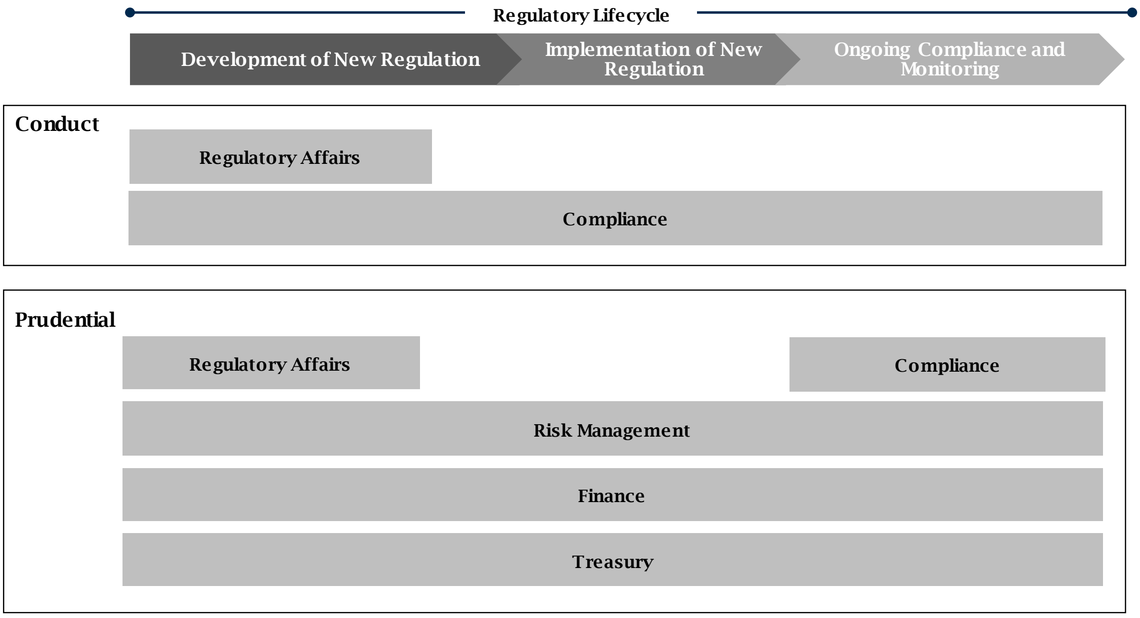
[65] It is likely that with the advent of the Basel 3 liquidity rules, the Treasury functions of the large banks would also be involved in monitoring regulatory developments. However, this could not be verified as the sampling strategy did not include organizational actors from Treasury.

management and finance experts and IT professionals were created to manage a programme of work to achieve compliance. In other organizations, such as Banks 3 and 4, any changes required to implement the new Basel 3 rules were managed as part of the 'business as usual' (BAU) operations of the bank, with no need for additional project staff to support this work. The key determining factor as to how regulatory change management was organized seemed to be the scale of the work required, which in turn, clearly depended on the scale of the operational impacts on the bank.

Figure 5.3 Responsibilities for managing regulation across the regulatory lifecycle



In the final stage of the regulatory lifecycle, the ongoing monitoring of compliance with prudential regulation tended to be a shared responsibility between compliance, risk management and finance. The practices associated with the three stages of the regulatory lifecycle are discussed further below.

The distinction between conduct and prudential regulation also had a bearing on the parts of the organization that were responsible for regulation. Conduct regulation refers to matters of consumer and investor protection, financial crime and market abuse. Typically, such matters have been the responsibility of the Compliance functions in banks (Mills, 2011). Conduct regulation, and changes to these regulations, has the greatest relevance for the Front and Back Offices and Compliance. However, changes to prudential regulation, with its emphasis on both risk management and capital calculations, had a greater impact on Middle Office functions such as Risk Management, Financial Control and Accounting. Group or Central Risk Management and Accounting functions are also heavily involved in prudential regulation.

One of the reasons that different areas of the banks were responsible for managing conduct and prudential regulation respectively was the depth and diversity of the skills and expertise that was necessary for dealing with the changes to the prudential rules. As Chapter 3 showed, the rules were highly complex and technical, covering a range of risk types and requiring complex underlying technology systems. Within Risk Management, the mathematical requirements of regulatory risk models demanded specialist quantitative skills, often gained through advanced scientific degrees (Weatherall, 2013). Several of the interviewees in Finance had been involved in regulatory interpretation for most of their careers, becoming expert in specific areas of the prudential rules and experienced in advising other parts of the business on their application. Staff in regulatory liaison roles also possessed specialist relationship management skills such as being effective communicators, and they often had many years of experience in dealing with regulatory authorities, either in their banking careers or through previous employment as a regulator.

This overview, whilst brief, suggests that the organizational structures in place for managing prudential regulatory change were somewhat fragmented, with responsibilities assigned to several different areas within a bank. Potentially, this could pose problems for the co-ordination of the work necessary for regulatory implementation, especially across teams that have different organizational sub-cultures and priorities, such as Risk and Finance (Chartis Research, 2013; Economist Intelligence Unit, 2011). For example, Finance departments tend to focus more on the reporting of the previous year's financial results whereas Risk has a more future-oriented perspective (Economist Intelligence Unit, 2011, p. 10). The dispersal of responsibilities for different aspects of regulatory change across the organization might also lead to confusion about who is accountable for what and the fragmentation of important data (Turner & Pidgeon, 1997; Vaughan, 1992). At this point, however, these suppositions must remain speculative because of the lack of in-depth data about any one organization and the fact that there was significant re-organization underway in the banks during the fieldwork period, which is discussed in greater detail below.

Practices

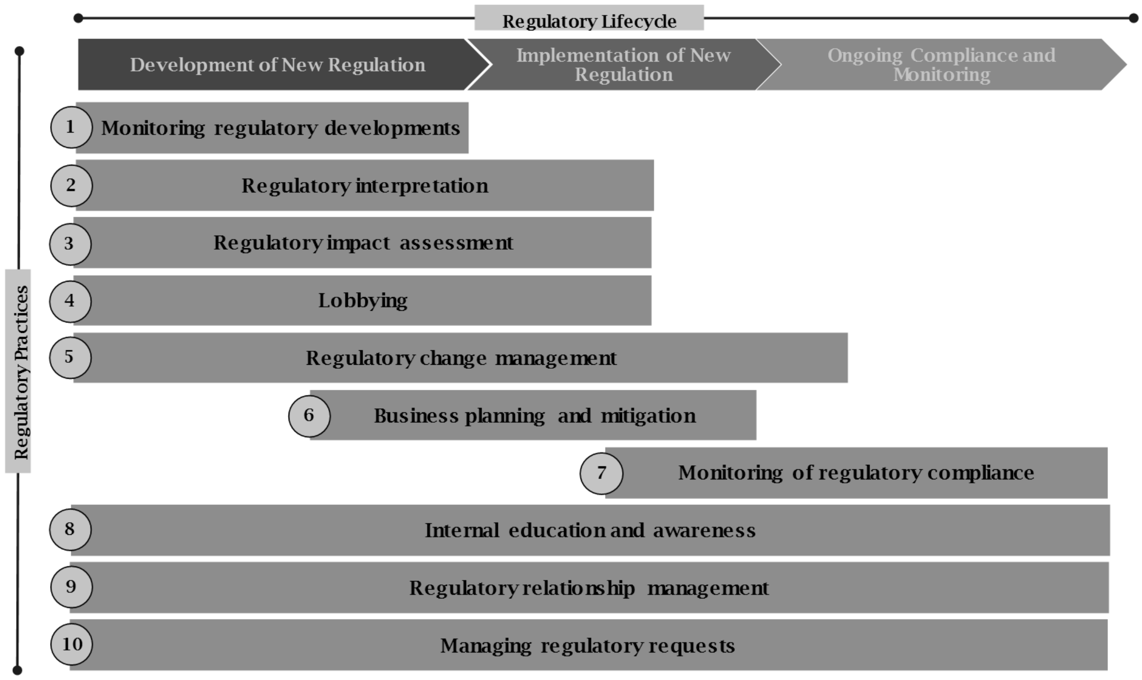
During the interview fieldwork, respondents were invited to describe their roles within the organizations they worked for, their responsibilities and how they managed the challenges of regulatory change. From their responses, over sixty separate activities were identified during the coding process and these were then further categorized into ten distinct types of regulatory practices. As Table 5.2 shows, activities relating to each practice category were coded in more than half of the interviews showing consistency in practices across the banking organizations (except for monitoring regulatory compliance).

Table 5.2 Regulatory practice category coding

Regulatory Practice Category	% of interviews coded to category	No. of References
Regulatory relationship management	100	101
Internal education and awareness	82	61
Lobbying	55	45
Regulatory impact assessment	64	40
Regulatory change management	64	36
Managing regulatory requests	59	31
Regulatory interpretation	55	23
Business planning and mitigation	50	21
Monitoring regulatory developments	55	17
Monitoring regulatory compliance	14	3

These regulatory practices have been mapped to the regulatory lifecycle as shown in Figure 5.4. Different categories of regulatory practice varied in importance depending on where a particular set of rules was in this regulatory lifecycle. During the first phase, actors within the organizations focused on monitoring the developments of new regulations (1). This consisted of checking for the release of new discussion or consultation[66] papers by the regulatory standard setting bodies on a national, EU and international level and other communications from regulators that indicated new or changed regulation on the horizon.[67]

Figure 5.4 Regulatory practices over the regulatory lifecycle



Once the relevant consultation papers had been identified, the next step was to review these proposals to ascertain their meaning (2). This interpretive work was necessary for banks' employees to then understand the potential impacts – both qualitative and quantitative – of the regulatory changes. By performing 'regulatory impact assessments'[68] (3) bank staff developed a view of the operational changes they needed to make and the possible financial impacts of the regulation. These assessments enabled decision making about the programme of work required to achieve compliance and directed the priorities for the organization's lobbying activities.

[66] In the very early stages of making new regulatory rules, standard setters will release a discussion paper, describing their early thinking which explicitly invites comment from industry and other interested parties.
[67] Though it was not mentioned by any of the interview respondents, external data suppliers such as Thomson Reuters provide services and software to which banks can subscribe to be kept up to date with the latest regulatory developments and management consulting firms also provide their clients (and prospective clients) with frequent regulatory bulletins.
[68] The regulatory impact assessments performed by banks should not be confused with Regulatory Impact Assessments performed by standard setters to assess the costs and benefits from the implementation of a piece of regulation (See Baldwin et al., 2011 Chapter 15).

Lobbying (4) encompassed a broad range of activities from responding to regulatory consultation papers, negotiations between senior executives and senior policy-makers and participating in the lobbying activities of trade associations. In parallel, the output of the regulatory impact assessments was also used to determine all the changes necessary to bring the organization into compliance with the new regulations. These change management practices (5) included modifications to technology systems, business processes, data management and organizational structures. To meet the regulatory deadlines, these practices would ideally begin as early as possible in the regulatory development phase of the regulatory lifecycle and continue into the implementation phase. The precise timing was dictated by the scale and the complexity of the changes that the organization needs to make.

Depending on the results of the quantitative impact assessment, banks may also have needed to take pre-emptive action to mitigate the financial impacts of the proposed regulations (6). Such actions included making changes to the business model, product mix or raising additional levels of capital (equity) (McKinsey & Co, 2010).

The final stage of the regulatory lifecycle required the continual monitoring of organizational compliance with the regulation once all the changes had been implemented and the new rules were in force (7). For prudential regulation, banks are required to conduct annual self-assessments of their risk model compliance to which senior management must attest and which are reviewed by the banks' Internal Audit department[69] (Prudential Regulation Authority, 2013b).

In addition to activities which are specific to the various stages in the regulatory lifecycle, three categories of continuous regulatory practices were also identified. The first was the communication of regulatory information within the organization (8). This ranged from informing the entire organization of the changing regulatory rules to intensive training of employees on specific aspects of the new rules that affected their day-to-day work.

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[69] Internal Audit is a department within a bank which provides independent and objective assurance regarding the risks, controls and governance to the Board and senior management of that organization.

The banks also had individuals or teams (depending on their size) dedicated to managing the relationships with all the regulators that oversee the bank (9), described as Regulatory Affairs departments above. This relationship management included activities such as responding to regulatory communications, organizing and preparing for regulatory meetings, tracking outstanding regulatory compliance issues and being the key point of contact between the regulators and the rest of the organization.

The final category of practices, the management of regulatory requests (10), tended to fall into two types – regular or scheduled reporting and ad hoc requests. Regular requests were a set of reporting requirements issued by the national supervisor and consisted of pre-determined set of data that the bank had to supply in a specified on an ongoing basis (Prudential Regulation Authority, 2016b). Ad hoc requests tended to be issued by a banking supervisor as part of an industry-wide review, or to gain clarity on a specific issue that has arisen with that particular organization. Respondents reported that such requests could arise at any time and often had fairly short deadlines for response.

This section demonstrates that there were a wide range of practices associated with the management and practical implementation of regulatory change. The relative importance and effort expended on these various activities varied in line with the regulatory lifecycle, though some practices were performed continuously. Moreover, the responsibilities for these practices were largely shared between three key departments - Regulatory Affairs, Risk and Finance – where the required specialist skills and knowledge were located.

Pache and Santos (2010) propose that the degree to which competing or conflicting institutional logics are represented within an organization will have a bearing on how these conflicts are handled and the type of response strategy that is mobilized by the organization. The power relations between the representatives of each logic and the political skills they possess are also likely to have an influence on the strategic direction an organization takes in response to environmental change (Almandoz, 2014; Greenwood et al., 2011; Pache & Santos, 2010). In the case of the management of regulatory risk, the argument made here is that there are specific organizational roles which can be viewed as the embodiment of regulatory logic – such as the employee responsible for regulatory liaison, or the Risk Manager who was the 'business sponsor' of the Basel 3 change programme. These individuals are therefore the agents of that institutional logic (Scott, 2007) and contribute to the internal representation of that logic. Likewise, the traders in the Front Office, responsible for maximizing revenues through the dealing of bonds, derivatives or shares, represent and embody the logic of the market.

Managing the risks of regulatory change

Having provided some background information on the types of structures and practices that the respondents described to manage regulatory change, further analytical work needs to be done to understand how these comprise the governance, tools and processes of the *risk management* of regulatory change. To do so, this section draws on the analytic themes raised by Hutter and Power (2005) in their metaphor of 'organizational encounters with risk'.

This metaphor consists of three lenses which are used to explore how organizations experience and respond to risks. The first, **organizational attention** to risk relates to the problematization of risk, how it is identified, measured and calculated and the technologies of control that are used in these activities. Secondly, **sense-making** about risk is undertaken in response to 'errors, accidents and anomalies', a means by which organizations attempt to understand risks and 'transform new encounters with risk into acceptable managerial practices' (Hutter & Power, 2005, p. 19). The final perspective examines the **re-organizing** undertaken in response to risk, including efforts to improve risk control and management throughout the organization. In line with Hutter and Power (2005, p. 6), these three perspectives are not offered as sequential stages that map easily on to either the regulatory lifecycle or the temporal phases that were identified in Chapter 4. Instead, the activities described under each heading were often undertaken in parallel or iteratively. At this point, it is worth reiterating that the risks that the banks are managing here are those associated with regulatory change such as the risks to bank profitability, the reputational risk of non-compliance and/or the risk of regulatory sanctions. The importance attributed to each of these risks by organizational actors will depends on the institutional perspective from which the risk is considered.

Organization of attention

Key to the anticipation and management of the putative harms of regulatory change – adverse financial impacts and non-compliance – was the identification of all the potential regulatory rule changes that emerged after the crisis. This was one of the most frequently cited processes in the fieldwork interviews. As noted in Chapter 3, the new rules produced by the European Union alone since the financial crisis numbered at least 2,000 pages (Haldane, 2012). Globally, the number was much higher. In its 2012 Annual Report, RBS stated that it had 'reviewed over 320 consultations in its core markets' (Royal Bank of Scotland, 2012a, p. 285). It is therefore not surprising that, as one interviewee contended, it was difficult to 'keep up with the tremendous pace of regulation' (Participant 17, 2014). Participants from each of the five banks in the interview sample explained that there were people or whole teams responsible for what was variously described as 'horizon scanning' (Participant 22, 2014), 'upstream risk management' (Participant 10, 2014), 'regulatory developments' (Participant 7, 2013), 'watching for what is on the radar' (Participant 8, 2013), 'monitoring what was coming down the line' (Participant 15, 2014) or 'looking at policy developments' (Participant 18, 2014). Banking organizations used a range of methods to monitor regulatory developments from scanning the standard setters' websites on a regular basis (B2P1) to engaging external public affairs consultancies to keep them updated with the latest progress in Brussels (Participant 10, 2014; Participant 13, 2014). Interviewees from both Bank 1 and Bank 5 described how all these changes were added as 'regulatory risks' to a central repository of regulatory risks and issues.

Once regulatory rule changes were identified, the interviewees stressed the importance of communicating them more widely to three key internal constituencies – senior management, impacted business areas and the wider organizational community. Firstly, the respondents described how senior management needed to be educated about the imminent changes to ensure appropriate levels of attention were paid to the new regulatory rules for two purposes. One, to mobilize resources and budget to satisfy the compliance requirements of the new changes and two, to educate senior management about the likely operational and financial impacts on the organization.

About a quarter of respondents stated that there was greater senior management attention on regulatory changes since the financial crisis:

> *'I brief the CFO [Chief Finance Officer], and the CRO [Chief Risk Officer] on a weekly basis on this sort of [regulatory change] stuff. And they get it. They have a good grip on it. And probably twice a month I go to committees and brief the CEO on it, and he's got a pretty good grip on it.' (Participant 20, 2014)*

Organizational actors with expertise in particular technical matters or in parts of the bank likely to be most impacted by the regulatory changes were also a key target of internal communications. Governance structures such as formal committees or informal groups were used for this purpose and comprised representatives from business functions likely to be most affected by the reforms:

> *'We've got, I guess I would describe it as trusted generals of the Finance Director, the Group Treasurer, we've got risk representatives - various senior risk representatives - on the strategy side, and on the operation side of risk. The senior finance representatives and it's - a little bit light in terms of business representation. But we get people from the businesses to join as and when. And then Public Affairs and Compliance.' (Participant 15, 2014)*

Respondents who were directly responsible for tracing and monitoring regulatory developments stressed the need to communicate about these as early in the regulatory lifecycle as possible:

> *'we typically go out quite early in the process of finding the business owner, because we are not close enough to the customer to necessarily understand all the subtleties, all the implications of the proposals so we'll go out [into the wider organization] and get that owner' (Participant 22, 2014).*

An early recognition of future regulatory changes and its associated risks, respondents suggested, would place the bank in a better situation to manage that change, thus improving the organization's ability to implement any operational modifications on time and potentially influencing the final shape of the regulation through lobbying.

Finally, respondents also highlighted that it was important to educate the wider organization about changes in the regulatory environment. This was partly because in some cases, there was a demand for this information due to an organizational recognition of the growing importance of regulation in the post-crisis environment:

> *'It's far more on people's minds, no matter who you are talking to in the business…everyone now wants to know…not necessarily out of personal interest but out of obligation, about regulation' (Participant 13, 2014).*

Communication of regulatory changes was evidently seen as critical to managing regulatory risk, according to the interview respondents. However, at the same time they acknowledged that this was sometimes difficult. The problems associated with risk communication in large and complex organizations is a consistent theme in the sociological literature on organizations and risk (Hutter, 2001; Reiss, 1992; Turner & Pidgeon, 1997; Vaughan, 1992). Turner and Pidgeon suggests that this can be in part because organizational attention is directed elsewhere, towards problems that are well-defined (Turner & Pidgeon, 1997, p. 49). Indeed, respondents discussed the difficulties inherent in their attempts to get organizational members to attend to regulatory changes, particularly when implementation dates were some time in the future or they were focused on 'firefighting' more immediate problems:

> *'the challenge is around identifying relevant stakeholders and getting views back from busy people, and trying to get people to focus on tomorrow's problem as opposed to today's emergency' (Participant 10, 2014).*

In other cases, however, interviewees reported that it has become easier to get some organizational groups to pay attention to regulatory change, especially if the financial risks of the new rules were highlighted:

> *'There's more people now stepping into the regulatory space because the front office need to have a view of strategy and that kind of stuff so you have almost like regulatory teams in the front office…capital management type teams that are looking at the capital in terms of the rules' (Participant 7, 2013).*

It is possible that because of the work that had been done to assess the capital impacts, these regulatory changes were better defined but perhaps more importantly, articulated using the logic of the market. By doing so, it appears that the areas of the organization that wielded the financial power i.e. the Front Office, were more likely to pay attention. This echoes previous findings about Compliance Officers needing to make a 'business case' (Parker, 2002) or to identify with the profit maximizing objectives of the firm (Weait, 1996) in order to garner wider organizational support for compliance initiatives.

Despite the sometimes variable levels of attention to regulatory change in the banks, the interview data also revealed that there was generally greater knowledge and awareness of regulation overall than before the crisis across all five sample organizations. This was especially the case when the impacts of the regulatory changes were articulated using market logic, such as the increased levels of capital required by the new rules.

The risks of regulatory change were not just associated with the changing nature of the regulatory rules, however, the ongoing relationship with the banks' supervisors was also perceived as a source of risk, especially given the increasingly intense and intrusive nature of the supervisory approach described in Chapter 3 (Financial Services Authority, 2008a; Prudential Regulation Authority, 2014b). In addition, the regulators themselves were in a state of flux, making it more difficult for the banks to predict the outcomes of their interactions. As Table 5.2 shows, practices associated with the regulatory relationships were most commonly discussed by the interviewees, indicating that paying attention to their supervisors had become more of an organizational priority.

As described above, responsibility for liaising with the prudential supervisor was typically centralized into one department, usually called Regulatory Affairs or Regulatory Liaison. The activities performed by this department included preparing for regulatory encounters, overseeing and minuting these interactions and then following up on any issues or actions that arose during them.

> *'There's the continuous relationship-building and maintenance with key people, and then there's the pro-active or reactive engagement on specific issues. So, that's that. And then of course, you have a more supervisory side - the day-to-day interactions between core compliance and the supervisor, but also senior management with the key regulators' (Participant 13, 2014).*

Prior to meeting with regulators, representatives from Regulatory Affairs would ensure that the meeting participants were fully briefed and that all the necessary information and materials had been prepared in advance. During the meetings, minutes were taken and added to a repository containing information on all contacts with the organizations' supervisors. Finally, Regulatory Affairs would ensure any key actions arising from a meeting or other communications with the regulator were completed and that the outcomes or issues raised by the regulator were disseminated to the appropriate personnel. For the employees in Regulatory Affairs, ensuring good regulatory relations and facilitating regulatory compliance were core to their organizational roles and thus these practices and activities were indicative of an orientation towards regulatory logic.

Interviewees from Banks 1, 2 and 4 all emphasized the importance of maintaining 'constructive' relationships with the PRA, with the aim of ensuring 'a high quality engagement and both sides…come away from it feeling they've extracted value' (Participant 18, 2014). Attention to regulatory relationships can therefore be viewed as contributing to the management of the risks of non-compliance. Literature on regulatory interactions (McCaffrey et al., 2007; Pautz, 2009; Pautz & Wamsley, 2011; Smith, 2013) suggests that 'cooperation, along with other conditions such as trust and common expectations, enhances regulatory interactions which can lead to improved regulatory outcomes' (Pautz & Wamsley, 2011, p. 7). Cooperative regulatory interactions may also have the effect of reducing friction and tension in the regulatory relationship, with less management time and effort needing to be spent on dealing with problems arising from such tensions. However, a small number of respondents also mentioned that there was a balance to be struck between paying supervisors enough attention and making 'sure they don't take over your life, as you might say, because then you can't get your job done' (Participant 19, 2014). In these cases, the respondents tended to occupy senior positions in risk management departments and were articulating a need to reach a pragmatic accommodation between the tensions of attending to the institutional demands of regulation and the other demands of their organizational roles.

Sense-making

Sense-making in relation to regulatory risk management refers to a set of practices which create and construct the meaning of the regulatory changes and their associated impacts on the banking organization. Sense-making is necessary when organizations experience shocks that disrupt their ongoing flow of activities (Weick, 1995, p. 85). The need for sense-making is further intensified in situations of complexity, uncertainty and instability, all of which characterize the regulatory environment after 2008. For Weick (1995), organizational sense-making is a collective, social activity but this does not necessarily mean that all organizational actors will construct the same meaning (Hutter, 2001). Where organizations are navigating situations beset with ambiguity and uncertainty, several different interpretations of the same situation may be available simultaneously, suggesting that arriving at one particular view is potentially problematic.

For actors in banks attempting to understand the new Basel 3 and CRD 4 rules, there were high levels of ambiguity and uncertainty. Law, including regulatory law, is by its nature ambiguous (Edelman, 1992; Edelman, Petterson, Chambliss, & Erlanger, 1991). However, to decide how best to manage the various risks of regulatory change (including non-compliance and adverse financial impacts), those responsible for managing this change within banks had to ameliorate this ambiguity by arriving at a satisfactory interpretation of the new regulatory rules.

In one organization, a formalized process for 'regulatory interpretation' of the CRD 4 rules had been established. This comprised an 'interpretation working group', responsible for ensuring there was a shared understanding, 'article[70] by article what each and every one meant' (Participant 10, 2014). Another respondent from a different bank mentioned that they might, on occasion, seek external legal guidance on rule interpretation 'there's always consultancy and law firms, particularly law firms, for these kinds of matters' (Participant 13, 2014). In a third organization, the main responsibility for the interpretation of the entirety of the CRD 4 text fell on one individual (Participant 20, 2014). In all the banks, there were key 'subject matter experts' who had gained deep knowledge of the regulatory rules throughout their careers – usually located within Risk or Finance. These people were critical in the process of regulatory interpretation and

[70] 'Article' here refers to a specific rule paragraph within the legal text of the CRD IV Directive

sense-making and appeared to constitute an informal community of experts, who would consult each other about rule meanings and their application to specific situations. These were very much informal networks, born out of shared expertise and practices.

Three of the interviewees from Finance departments were specifically responsible for the ongoing interpretation of the prudential rules – both the existing rules and the rules that were changing. Their job was to provide guidance and advice to the Front Office with respect to the regulatory implications of certain types of transactions or when new products were being developed. One interviewee described the frustrations associated with this task:

> *'I'm dealing with colleagues and say well, the laws says that and they turn round and say well, it doesn't make sense so I'm going to do this. And I'm saying but you can't, the law is actually saying something and you can't turn around and say you don't like it' (Participant 6, 2013).*

In this example, the representative from Finance was providing advice which ran counter to the interests of his Front Office colleague. However, this particular situation was resolved by the actor from the Front Office being obliged to follow the finance expert's interpretation, representing not only an interpretive struggle over the meaning of the law, but also perhaps demonstrating an intra-organizational contest of power and interests. In this case, the Front Office employee represented or embodied the logic of the market, whilst the interviewee occupied a role imbued with regulatory logic. These two sets of actors came into conflict when sense-making over regulatory changes occurred. It is not clear that regulatory logic always prevailed, but the interview evidence does seem to indicate that greater organizational power was being afforded to organizational actors whose roles embodied regulatory logic than before the financial crisis.

The practice of regulatory interpretation also involved organizational decision-making about the level of regulatory risk that the organization was prepared to tolerate. Two examples will help to illustrate this point. The first relates to the risk of non-compliance. Determining the meaning of a rule often requires a debate between the 'letter of the law' and the 'spirit of the law'. The interpretation then not only necessitated an understanding of the intention behind the rules but also a decision about the desired level of regulatory compliance that would be achieved by interpreting the rule in this specific way:

> *'You look through to the spirit of what do they actually mean, what is the intention, and that's where you have the flexibility to go – this is what they're saying, rate ourselves 1 to 10 on here. We're a seven, is seven enough? Seven might be okay. Doesn't mean you have to do ten out of ten.' (Participant 3, 2013).*

This quote illustrates that conscious decisions were made about the 'level' of compliance that organizations were aiming for and considered in their interpretations of the rules. It also illustrates that banks' understanding of compliance was not binary but was judged on a continuum, which echoes findings in other studies of regulatory compliance (Hawkins, 2002; Hutter, 1997).

Different interpretations could also have a direct impact on regulatory capital levels. One respondent described a situation where for certain portfolios, the bank did not have permission to use the advanced modelling approach to calculate the capital requirements for market risk. However, when reviewing the rules for calculations using the standardized approach in greater detail, this employee realized that two options were available for how hedging transactions could be treated. One option would result in a lower capital requirement and this was the interpretation that was chosen. The respondent reflected that

> *'with a bit of advice you can actually change the way the business (Front Office) operates to avoid taking punitive or unnecessary charges which is really around the education about how a very specific rule works' (Participant 5, 2013).*

This second example demonstrates that in addition to considerations of compliance, attitudes to risk and risk taking were also involved in decisions about regulatory interpretations. Higher risks would have brought higher returns but they would also have required higher levels of capital.

Driven both by regulatory requirements (BCBS, 2010e) and the growth of risk governance (Power, 2007), banks have increasingly expressed their levels of risk tolerance through formal statements of 'risk appetite'. As Power argues, 'such an "appetite" is in the first instance revealed by what organizations actually do (rather than what they claim to do)' (Power, 2007, p. 77), Both the examples above illustrate that the notion of 'risk appetite' has a role to play in the process of sense-making associated with regulatory change. The appetite which an organization has for both the risk of non-compliance and the risk of adverse financial consequences come together and are balanced in the overall articulation of the appetite for regulatory risk, representing a truce in the conflict between market and regulatory logics.

Typically, risk analysis or assessment processes include an estimation of both the probability of a risk and its likely impact. In the case of post-crisis regulation, the uncertainty was not so much due to the probability of the regulatory change – once the intention to reform the prudential regulatory framework was announced by the G20 in 2009 (G20, 2009), the changes were almost inevitable. However, the uncertainty lay in the potential impacts of the changes on the banking organizations, a clear example of 'effect uncertainty' (Milliken, 1987). Interview respondents discussed the processes they used to assess the impact of the regulatory changes on their organizations which were very similar across all five banks. Each separate regulatory change was logged as a 'regulatory risk' and the first step was to conduct a 'top down' view of the impact on the bank. One interviewee described this process in detail, explaining the types of criteria that he and his team used to classify the regulatory risks such as 'financial impact, reputational impact, operational impacts' (Participant 10, 2014). Depending on the level of impact, each regulatory risk in the 'risk log' was assigned a classification of either low, medium-low, medium-high or high. This classification then dictated how the risk was managed in the organization. Those that were medium-high or high across the bank as a whole were managed centrally and prioritized over others but 'there will also be a long tail of lower-level, medium low or low impact issues which will obviously tend to get managed locally' (Participant 10, 2014). At the time of this interview, this respondent stated that there were 'about 150 [regulatory risks] which are viewed as medium-high stroke high for the Group' (Participant 10, 2014).

An interviewee from another bank described a similar process of assessing changes as a 'function of customer impacts, financial impacts, balance sheet impacts and reputational impacts' (Participant 22, 2014). In his organization, they had 'about eighty live issues at any one time, and it's been as high as a hundred, been as low as sixty, but eighty is roughly the average' (Participant 22, 2014).

Despite these very mechanistic processes for measuring the impacts of regulatory risks, both the interviewees quoted above acknowledged that the process of assigning an impact classification was not as 'scientific' as it sounded:

> *'So on financial impacts for instance, impacts on RWAs [Risk Weighted Assets] for instance, there are various functional thresholds, but .... at the end of the day you need to exercise some sort of rounded judgements so just because you trigger one threshold, doesn't automatically make it a high or medium high impact' (Participant 10, 2014).*

In recognizing the role of judgement in assessing the impacts of regulatory risks, this respondent was highlighting the difficulties inherent in trying to render the uncertainties of the future somehow measurable in the present. Perhaps the function of these risk assessment processes was not so much the accuracy of the estimated scale of the impact as much as its plausibility (Weick, 1995). Classifying a regulatory risk as high might well have been contested by other actors within the organization but the very act of classification made these risks more visible, drawing attention to the regulatory changes and putting them on the managerial agenda.

Once an initial estimate of the overall impact of the regulatory changes on the organization had been determined, respondents reported that more detailed impact analyses were then performed to address both the risk of non-compliance and the risk of adverse capital impacts. The sources of the risk of non-compliance came from both within and outside the bank. The unpredictability of regulatory expectations was not something the organization could directly influence. However, the bank staff attempted to understand the operational changes that were necessary to comply with the new regulations and developed a programme of work to address them. To achieve this, interviewees from three of the banks described what appeared to be a standardized technique called a 'gap analysis':

'the way to do it is to pretend it's [regulatory change] already happened and see where the gaps are. So, say this is where we are, this is where we're going to be, these are the gaps, these are the implications' (Participant 20, 2014).

This process of analysis allowed the organization to identify which policies, processes, structures, risk models and technology systems would continue to be compliant with the new regulations and which would need to be modified or created from scratch. The outcome of this analysis formed the basis for a plan of work that would then be executed as part of the practice of 'regulatory change management' described in the next section. This 'operational impact analysis' work was usually performed by organizational functions from the middle and back office such as IT or risk management.

Managing the financial impacts of the regulatory changes was influenced more by considerations of market logic. A different type of impact assessment was used to estimate more precisely how each of the rule changes would affect the banks' capital requirements and ultimately their capital ratios[71]. These were known as quantitative impact assessments or studies[72]. The estimates produced by these assessments were included in the banks' annual reports to provide investors with a sense of how the regulations might affect the banks' key financial ratios in the future:

'Basel 3 numbers have been disclosed in the annual report and accounts for at least the last past eighteen months though of course, the early estimates were exactly that, given the lack of certainty in the final rules' (Participant 5, 2013).

Where Basel 3 introduced new requirements, such as the additional capital charge for credit valuation adjustments (CVA), estimating the impacts of these changes was

[71] Similar exercises were conducted to assess the impact of new liquidity rules but none of the interviewees recruited for this study were involved directly in implementing the new liquidity rules that were part of Basel 3.

[72] It should be noted that quantitative impact studies (QIS) are also a tool used by the BCBS to assess the effects of changes to the Basel rules on the overall levels of regulatory capital in the financial system and in some cases, are used to adjust the calibration of the rules. For the Basel 3 proposals, an initial QIS was conducted in 2009 and the results published in 2010 (BCBS 2010). In addition, the BCBS runs a semi-annual exercise to monitor the impact of Basel 3 on the international banking system on an ongoing basis. Over 200 international banks participate in this exercise.

particularly problematic because the risk models and systems infrastructure required to perform the calculations had not yet been put in place:

> *'there's a lag time, we know there is something that we need to understand better but we don't yet have the tools to understand it in a way that we need to understand it' (Participant 9, 2013).*

There was, therefore, a recognition that the capital impact estimates were inaccurate and when disclosed internally and externally, they were accompanied by a host of caveats and assumptions:

> *'Sometimes the hardest thing is actually, once you've arrived at your central case as to where you think the capital will end up, then drawing the error bar on that, which is the uncertainty associated with how the rules might change' (Participant 17, 2014).*

Unlike the operational impact assessments, the internal consumers of the outputs of the quantitative impact assessments tended to be senior management and the revenue-generating parts of the organization. This respondent described why this was the case:

> *'for Basel 3, most areas end up with higher capital which is clearly the regulators' objective so everybody has to take that seriously and the organization has to decide where it is going to allocate that limited resource because raising capital in the current climate is not going to be a straightforward exercise. There isn't going to be investor incentives to put into banks that have become less and less profitable given the risk return' (Participant 5, 2013).*

This quote is also a clear articulation of the market logic that framed sense-making about the scale of the potential capital impacts. Again, precise accuracy in these calculations was not possible to achieve but an indicative scale of the impacts was a vital input for shaping the bank's business and financial strategy to mitigate the capital impact, to prioritize lobbying activities and to inform investors (Ernst & Young, 2014; McKinsey & Co, 2010).

A final point that several respondents raised about the practice of regulatory impact assessments was that it was not a one-off activity. As discussed previously, the Basel 3 and CRDIV regulatory proposals evolved over a period of time, often consisting of several iterations of the new rules which become more and more detailed as time progresses. Banking organizations, therefore, needed to keep track of these iterative changes:

> *'at an early state, you're dealing with concepts and high-level proposals rather than more detailed draft regulations, for instance. So as and when you get more detail, you have to keep going back to your impact assessments' (Participant 10, 2014).*

A tension emerges here, between having enough certainty or plausibility as a result of sense-making to enable action whilst at the same time, having to continually factor in additional changes to the impact assessments and ultimately the implementation programme. This tension manifested itself in interactions between different parts of the organization. For example, one respondent from a regulatory advisory team within a central finance function was responsible for 'signing-off' on a set of business requirements documents. These texts articulated the detailed changes required to technology systems and business processes to bring the bank into compliance with specific aspects of the new CRD 4 rules:

> *'The CRD 4 programme is getting very frustrated because I can't sign off on business requirements documents. We obviously did a complete interpretation of the draft CRD 4 and then we were told not to look at any changes as they went through the various iterations until we got to the final text. Of course, now we've got the final text they want me to sign off on the changes from the initial text to the final text…I am more worried about the RTS [Regulatory Technical Standards] so I am resisting this and of course, that gets me into trouble for not being cooperative' (Participant 6, 2013).*

Participant 6 was a deep technical expert and with this expertise came the power to delay progress due to what he perceived as an intolerable level of uncertainty. However, those responsible for implementing the practical changes were prevented from doing so until his permission had been granted. This tension was between those with expertise on regulatory policy and implementation and those involved in the work programmes to implement the regulatory changes who did not have the same level of technical knowledge. Whilst friction between the regulatory functions and the business (or Front Office) is somewhat predictable, the above example shows that different parts of the organization who subscribe to the same underlying regulatory logic may still differ regarding acceptable levels of risk or uncertainty. Processes of sense-making can reveal variable understandings and tolerances of risk, even amongst organizational constituencies that might have been expected to share similar 'ways of seeing' (Hutter, 2005).

Re-organizing

The final analytical lens through which organizational encounters with the risks of regulatory change can be viewed, according to Hutter and Power (2005) is that of the re-organization of structures, roles and management technologies within organizations. Such changes typically occur in response to the crystallization of risk events, and are 'contingent upon forms of collective sense-making' (Hutter & Power, 2005, p. 25). A high degree of re-organizing was evident in the banks included in the interview sample, both in terms of organizational structures and practices.

The interview data revealed that all five banks had undergone or were undergoing varying degrees of restructuring in direct response to regulatory change[73]. Most prevalent was the creation or reconfiguration of teams or departments specifically charged with managing regulatory change, the creation of new roles for managing regulatory relationships and hiring additional numbers of staff, including ex-regulators (see below). One respondent described how his organization was in the process of changing how the monitoring of regulatory developments was structured between the divisions and the Group Centre. He described how the reporting lines of the heads of the divisional Regulatory Affairs departments were being shifted from reporting locally to the divisional Chief Risk Officer to the Group Head of Regulatory Affairs. The reason given for this change was that many of the issues associated with the changes to the prudential regulations cut across divisional boundaries, such as data aggregation and information technology changes.

Within the investment banking division of one of the banks in the sample, respondents described a new function which had been set up within Risk Management. This team was specifically responsible for managing the regulatory relationship with the FSA/PRA regarding the credit risk models (which were going through a regulatory re-approval process) and to provide regulatory expertise to the Risk Management teams responsible for carrying out the work to remediate the models and associated processes.

[73] There was also a large degree of re-organization within the banking industry in general during the fieldwork period, driven more by market conditions and in response to events such as the Eurozone crisis.

New governance structures were also created specifically to manage regulatory change, where governance in this context means the structures of accountability and oversight for managing regulatory change. An example of such a structure is described by this interviewee:

> *'So we have established a full-fledged structure with a project management office and outside help from one of the big four [consulting companies] - we have the steering committee, which includes business heads, control function heads, corporate function heads. And then we have different working groups and task forces, all of which focus on the top twelve European regulatory initiatives' (Participant 13, 2014).*

Other examples given by respondents included a Regulatory Developments Executive Steering Group and a Basel 3 Implementation Steering Group. The former comprised senior executives such as the Chief Risk Officer and the Chief Finance Officer and its purpose was to make decisions about 'significant [regulatory] changes to the group in terms of the changes to potentially the structure, the way it conducts itself and the way it operates generally' (Participant 15, 2014).

Three out of the five banks in the sample had also created new roles specifically to manage relationships with the regulators. In one organization, there had not been a Head of Regulatory Affairs until 2010. Responsibilities for various aspects of regulation had been split between various members of the Group Legal and Compliance or Risk Management functions as this organization had not seen a need for a dedicated role. However, along with many other banks after the crisis, the increased regulatory scrutiny meant that managing the liaison with the regulators was occupying more and more management effort at a time when rebuilding regulatory relationships was considered to be an important priority (see Chapter 6). A similar sequence of events was described by this interviewee:

> *'The decision was taken that there was so much regulation, so much regulatory interaction, the regulators were also splitting - so the FSA was splitting, so there were more stakeholders to manage - that it actually needed its own dedicated resource to do that, and they needed somebody at director level, to just spend all day worrying about regulation' (Participant 18, 2014)*

The creation of new roles necessitated the recruitment of new staff to fill them and indeed, two of the respondents had not only been hired to fill roles as Head of Regulatory

Affairs, but they had been recruited directly from the FSA or PRA between 2012 and 2013. When questioned about their employer's motivation for bringing them into the organization, both respondents said it had primarily been to improve the relationship with the regulator. This practice of corporate firms hiring ex-regulators was also reflected by the fact that over a quarter of the respondents in the sample had been employed by a regulatory body at some point in their career.

The transition of experienced regulatory staff into industry typifies the 'revolving door', where staff move from industry to politics (or regulation) and vice versa. The 'revolving door' is considered by some commentators to demonstrate the existence of regulatory capture (Carpenter & Moss, 2013; Pagliari, 2012). Classic theories of regulatory capture contend that it occurs when industry interests are promoted and prioritized over public interest goals through processes such as lobbying (Stigler, 1971) and 'revolving door effects' (Makkai & Braithwaite, 1992). However, more recent variants have been proposed, including 'cultural capture' (Kwak, 2013) which considers relationships and network ties to be a mechanism through which the regulator's actions and beliefs can be shaped:

> *'The revolving door between government and industry, by creating social connections between people on opposite sides of the door, therefore has an influence even on people who are personally impervious to its attractions' (Kwak, 2013, p. 91).*

Recent work in the US has examined the flows of personnel between industry and regulators (and vice-versa) (Bond & Glode, 2014; Cadogan & Cole, 2012; Lim, Hagendorff, & Armitage, 2015; Lucca, Seru, & Trebbi, 2014). Whilst comparable academic studies in the UK are not yet available, anecdotally, a similar pattern can be observed in the UK banking industry. Table 5.3 shows the movement of several actors from the FSA to either banks or management consulting firms from 2010-2014.

Table 5.3 Examples of flow of regulators to industry in the UK (2010 – 2014)

Name	Year of move	Previous role and employer	New role and employer
David Strachan	2010	Director of Financial Stability Division	Co-Head of Centre for Regulatory Strategy

Name	Year of move	Previous role and employer	New role and employer
		Financial Services Authority	Deloitte
Sally Dewar	2011	Head of Risk Division Financial Services Authority	Head of Regulatory Affairs, Europe JP Morgan Chase
Thomas Huertas	2011	Head of International Affairs Financial Services Authority	Partner Ernst & Young
Andrew Whittaker	2012	General Counsel Financial Services Authority	Group General Counsel Lloyds Bank
Margaret Cole	2012	Head of Enforcement and Financial Crime Financial Services Authority	General Counsel PriceWaterhouseCoopers
Hector Sants	2013	CEO Financial Services Authority	Head of Government and Regulatory Relations Barclays Bank
Matthew Elderfield	2013	Financial Regulatory and Deputy Governor Central Bank of Ireland	Head of Compliance Lloyds Bank
Jon Pain	2013	Managing Director Supervision Financial Services Authority	Head of Regulatory Affairs and Conduct Royal Bank of Scotland
Christina Sinclair	2013	Director of Retail Financial Conduct Authority	Global Head of Compliance for Wealth and Investment Management Barclays Bank
Sheila Nicoll	2013	Director, Conduct Policy Financial Services Authority	Senior Advisor, Ernst & Young
Rosemary Hilary	2013	Head of Internal Audit Financial Conduct Authority	Audit Director TSB Bank (formerly part of Lloyds)
Colin Lawrence	2013	Director, Strategic Risk Advisor Prudential Regulation Authority	Partner Ernst & Young
Matthew Nunan	2014	Head of Wholesale Enforcement Financial Conduct Authority	Senior Compliance Role Morgan Stanley
Sharon Campbell	2014	Head of Financial Crime and Intelligence Financial Conduct Authority	Director of Financial Crime Santander UK
Julian Adams	2014	Director of Insurance Supervision Prudential Regulatory Authority	Group Regulatory Director Prudential (insurance company)

Sources: ft.com, citywire.co.uk, telegraph.co.uk, guardian.co.uk, Bloomberg.com linkedin.com

There was little evidence from the interviews about the reasons for hiring senior ex-regulators, aside from the general need to improve regulatory relations, but it is possible to speculate about a continuum of motivations. At one extreme, by bringing senior ex-regulators into the organization, a bank was very visibly signalling to both internal and external constituencies (including the regulator) that they are 'taking regulation seriously' (Participant 4, 2013) without necessarily having to make any substantive changes (though of course, they may also be making substantive improvements). This is commensurate with the need to pacify external sources of organizational legitimacy as discussed in Chapter 4. At the other end of the scale, it is possible to surmise that banks sought the knowledge, skills and expertise of these regulatory officials to better help them to meaningfully meet regulatory requirements and supervisory expectations. It is also worth noting that there are significant incentives for regulatory staff to move into industry, given higher levels of remuneration in the banks compared to the regulators.

The hiring of such senior regulatory officials, such as Hector Sants by Barclays Bank in 2013 was also symptomatic of an associated trend - the apparent elevation in the organizational status of those responsible for managing regulation. There is a precedent for the creation of new 'Chief Officer' positions in response to specific organizational issues, as documented by Power in his discussion of the rise of the Chief Risk Officer (CRO). Power argues that

> *'these positions provide internal organizational representations of externally encountered norms and rules. They are part of the way that organizations manage uncertainties in their environments, specifically those created by legislative, regulatory and market pressures.' (Power, 2005b, p. 137)*

Three explanations are offered by Power (2007) to account for the creation of the CROs in the literature. Firstly, that organizations are responding rationally to the increasing risks in their external environment. Second, the role of the CRO is part of a 'blame-shifting' strategy, the person to blame when risks crystallize. Finally, there is an institutional explanation, whereby the rise of the CRO can be attributed to an organization's legitimating project, as 'part of good governance together with audit committees and internal auditors' (Power, 2005b, p. 140).

The 'Chief Regulatory Officer' can be viewed both as part of the strategy to manage the risks of regulatory change and an attempt to repair organizational legitimacy (Suchman, 1995). He or she becomes an organizational figurehead for regulatory compliance, and as with the Chief Risk Officer and Chief Compliance Officer, he or she might well

> *'become quickly embroiled in a complex organizational politics in which their effectiveness and legitimacy is constantly in question, and the role may be a dumping ground for high-blame problems' (Power, 2005b, p. 139).*

At the same time, however, having a senior executive accountable for all regulatory matters could overcome some of the issues previously identified with the fragmentation of regulatory responsibilities in the organization. The ability of the 'Chief Regulatory Officer' to make substantive changes (if this is indeed the goal) will depend on two factors. The first is the status of the role within the organization, such as whether this individual is on the Board of Directors of the bank[74]. The second factor is the level of social skill that new employee has to 'motivate cooperation in other actors by providing those actors with common meanings and identities in which actions can be undertaken and justified' (Fligstein, 1997, p. 398).

In addition to the reconfiguration of organizational structures, two categories of regulatory practices were associated with re-organizing, Change Management and Business Planning and Mitigation. Change Management encompasses both a set of practices and specific structures created to manage the organizational changes necessary to bring the bank into compliance. As described above, in some cases, these change programmes were managed outside the day-to-day (or 'business as usual') activities of the firm with project staff specially recruited to work full time on regulatory change. One bank had engaged a firm of external management consultants to run their regulatory change programme because the knowledge and expertise to do so could not be sourced internally. Not only are consultants a source of knowledge, however, their engagement can also provide legitimacy, as 'certifiers of rationality' that 'signal to internal and external constituencies that expert knowledge is being applied' (Ernst & Kieser, 2002, p. 55) within the organization. Moreover, management consultants have

[74] Hector Sants, for example, was not a member of the Barclays Board in his role as Head of Government and Regulatory Affairs. It is worth noting, however, that at the time of writing, none of the five top UK banks had a Chief Compliance or Chief Regulatory Officer on the Board, and only one bank, Lloyds, included a Chief Risk Officer as Board member.

been identified as a significant non-state regulatory actors (Black, 2002a; Ernst & Kieser, 2002; Hutter, 2006b; Hutter & Jones, 2007; Power, 2007) and could potentially contribute to the isomorphism of regulatory practices through their role as 'model mongers' (Braithwaite & Drahos, 2000) but there is little empirical work on their use within regulation to support this conjecture.

Despite the potential usefulness of such external resources, another bank explicitly chose not to make use of them in managing regulatory change:

> *'there's a reluctance to use external forces, consultancies and so on. Primarily because of the cost, but also it's good to develop that knowledge and retain it within the organization as far as possible' (Participant 15, 2014)*

In banks such as this one, the management of regulatory change was performed by its full-time employees. Nonetheless, irrespective of the constitution of the project teams, the process of change management or regulatory implementation tended to follow a similar trajectory referred to as a 'project management lifecycle'. Practices described above such as the operational impact assessment were used to identify the changes that needed to be made. These changes were then broken down into discrete units of work and incorporated into a detailed plan. Tasks were then assigned to the various functions responsible for making the changes such as IT, Risk Management, Finance etc. A central team then monitored the progress of this work with oversight provided by the project or programme steering committee.

The types of changes that were required tended to be primarily technological, enhancing computer systems to capture additional information, for example, or making alterations to risk management processes or regulatory reports. In addition, respondents mentioned the need to implement internal controls, such as:

> *'day-to-day checks [of risk models], reconciling them with the Front Office, things like that, so we definitely notice a lot of focus on the control side of things' (Participant 9, 2013).*

The Basel 3 regulations also required banks to make changes to their risk management methodologies and models and the accompanying policies and procedures:

> *'if you use it [risk model] on a day to day basis is you would go into the control and credit unit and they are monitoring it almost like, or similar along the lines of an excess management type process and what that monthly committee would look at is much smarter type metrics – sector, concentration type stuff. So it's changed governance structures, it's changed processes, it's changed controls.' (Participant 4, 2013)*

These types of changes, then, represented the substantive reorganization that was necessary to implement regulatory change, and were unequivocally aimed at mitigating the risk of regulatory non-compliance.

However, a very different set of re-organizing practices was also described by several interview participants, categorized here as 'business planning and mitigation'. These practices were primarily concerned with addressing the large increases in capital requirements predicted by the banks' quantitative impacts assessments. The types of actions that a bank might consider ranged from fundamental business model changes, balance sheet restructuring to fixing small problems associated with the quality of their risk data.

> *'We talk about mitigating actions and one of them might be to sell a business. You're not to do that until the last minute because obviously, the longer you can hold it, the better it is' (Participant 6, 2013).*

Additionally, banks sought ways of 'optimizing capital', a rather euphemistic term for reducing levels of regulatory capital through changes to risk models and risk management processes, improving data quality or changes to accounting policies (McKinsey & Co, 2010, p. 15).

> *'Capital is a big thing so whilst you could say that a big driver behind the risk model change project…was internal credit methodology, one of the main drivers was really capital I think. Saving the bank a significant amount of money' (Participant 9, 2013)*

This pursuit of capital optimization or efficiency was corroborated by an Ernst and Young survey which found that seventy-six percent of the banks in the survey sample were 'undertaking capital efficiency initiatives to mitigate the effects of Basel 3 requirements' (Ernst & Young, 2014, p. 66).

The final type of mitigating activity described by the respondents was to address the banks' capital structure itself by improving the quality or quantum of capital via a rights issue or through liability management:

> *'We look to make our capital as efficient as possible, so over the past couple of years we've done some liability management exercises where we've paid back some lower non-eligible capital in order to then create more eligible Tier 1 regulatory capital' (Participant 18, 2014).*

The need for banks to reduce their balance sheets or raise additional capital in response to Basel 3 has been well publicized (Jenkins & Shaefer, 2013; Kollowe, 2010; McKinsey & Co, 2010; Thompson, 2013) and whilst this is sometimes framed by the industry and practitioners as problematic, it must be remembered that increasing the levels of regulatory capital was clearly one of the key objectives of the Basel Committee. The mitigating activities discussed above signify banks' efforts to manage the risk of reduced shareholder returns because, according to the industry, 'investors are not accepting lower ROEs but are instead pushing for increases in ROE. Investors are demanding cost cutting, including compensation.' (Ernst & Young, 2013, p. 54). Here, the demands of the market are driving banks to manage the risk of reduced profitability in direct conflict with the regulatory imperative to increase levels of capital.

Discussion

This chapter set out to explore the practices and structures instigated by banks in response to regulatory change, examining these within the context of the management of the uncertainty associated with a changing regulatory environment. One of the key questions was the degree to which these practices and structures can be said to be evidence of substantive changes. At this stage, it is not possible to give a definitive answer because the interview data is somewhat equivocal on this matter. Of the ten categories of regulatory practices that were identified, only one of these was directly concerned with making the changes to achieve compliance with the new rules – 'regulatory change management'. However, within this category of activities respondents did describe in some detail the types of operational changes that were being made, such as the development of new risk models and the creation of new control processes. This could be suggestive of some degree of substantive efforts to achieve compliance as could the significant levels of organizational restructuring to manage the risks of new regulations. By conferring greater authority on regulatory staff within the organization and hiring ex-regulatory personnel at some cost, it appears that banks are prioritizing the skills, knowledge and expertise of those occupying roles instilled with the logic of regulation. On the other hand, assigning greater powers to those responsible for managing the risks of regulatory change may be a ceremonial act, one designed to demonstrate to external audiences that regulation is being taken seriously as part of its legitimacy repair strategy (Suchman, 1995). Similarly, the adoption of practices to manage the risks of regulatory change could be viewed as a necessary part of a strategy of decoupling. A bank would still need to understand how to present the 'window dressing' of regulatory compliance without necessarily adapting its core activities. The thesis returns to this theme in Chapter 7, when the possibilities for the institutionalization of regulatory logic are discussed.

Power (2007) suggests that 'uncertainties become risks when they enter into management systems for their identification, assessment and mitigation' (Power, 2007, p. 5). This chapter argues that by constructing regulatory change as a risk, UK banks were attempting to effect 'uncertainty to risk transformations' (Clarke, 2001, p. 11) in an effort to mitigate the potential harms associated with a dynamic regulatory environment. The perception of what these 'harms' are varied based on the underlying institutional logic through which regulatory change was viewed. From the perspective of the market, the key hazard of the new prudential rules was the increase in capital requirements and the consequences of that such as reduced returns on equity. From a regulatory point of view, the main threat was of non-compliance with the new regulations which could arise through a misinterpretation or misunderstanding of the rules, a failure to implement changes in time or not meeting supervisory expectations for compliance.

Analyzing the types of activities and practices employed by the banks to respond to regulatory change clearly showed that these could be indeed be understood as practices of risk management, involving as they did the identification, assessment and mitigation of the perceived harms of the changing regulations. This analysis revealed a degree of isomorphism amongst the practices of regulatory risk management, indicating some similarities in banks' responses to the pressures of the institutional environment (DiMaggio & Powell, 1983). However, there were also differences in the structures that banks put in place to manage regulatory change such as the reporting lines for Regulatory Affairs departments and the use of external consultants so it is important not to overstate these similarities. In constructing regulatory change as an object of risk management, banks face similar problems to those identified in previous sociological work on organizations, regulation and risk. Understandings and perceptions of risk may vary within an organization (Hutter, 2001, 2005) and there are likely to be differing perspectives as to what risks should be managed and what levels of risk should be tolerated (Hood et al., 2001).

This chapter showed that institutional logics can have an influence on how the risks of regulatory change are understood and attended to by various actors within organizations. Actors who occupy organizational roles that are focused on regulation, such as those located in Regulatory Affairs departments or Finance Regulatory Advisory teams can be viewed as embodying regulatory logic. Other actors, such as traders in the Front Office are required (and incentivized) to contribute to the profit-maximizing activities of the firm and therefore are the personification of market logic. Senior management, however, inhabit more problematic roles whereby they have responsibilities to both uphold regulatory standards and ensure the financial success of the firm. However, as this chapter also demonstrates, just because an actor is in a particular organizational role imbued with a particular institutional logic, it does not mean that he or she cannot make strategic use of the symbols and practices of other institutional logics to effect institutional change. Indeed, Friedland and Alford (1991) contend that people can be 'artful in the mobilization of different institutional logics to serve their purposes' (Friedland & Alford, 1991, p. 254). In this case, the manipulation of market logic to garner support for regulatory initiatives is exemplified by regulatory staff emphasizing the adverse capital impacts of the new prudential rules in their interactions with Front Office personnel and senior management.

The uncertainty and ambiguity of the regulatory rules requires significant levels of sense-making and thus provides an arena where those organizational actors imbued with different institutional logics can negotiate meanings to enable action. It is here that differing conceptions of regulatory risk are presented and reconciled in the determination of the bank's regulatory risk appetite. Levels of regulatory compliance are balanced against potential financial impacts and the outcome will probably reflect the interests of the most powerful organizational constituencies and / or those who employ greater strategic skills in influencing other actors (Fligstein, 1997) which, following the financial crisis, is increasingly likely to be those occupying senior regulatory roles.

The elevation in the status of regulatory staff within banks provides support for the final claim of this chapter which is that the work to interpret and manage regulatory change as well as the relationships with the regulators is becoming increasingly professionalized within the financial sector. There appears to be an increasingly standardized set of isomorphic practices associated with managing the changes associated with the technically complex and constantly evolving prudential regulations. People who possess specific skills, knowledge and expertise are required to develop and execute these practices. They comprise a set of 'regulatory professionals' who constitute a 'community of practice' (Wenger, 2000) and are instrumental not only in the management of regulatory change but also in the management of regulatory interactions which is the focus of the next chapter.

Chapter 6: Regulatory interactions

In the wake of the financial crisis, the legitimacy of the banks and the regulators was called into fundamental question. In Chapter 4, the public approbation of banks was noted and their attempts to regain legitimacy through their public statements was discussed. The legitimacy of the regulators was similarly damaged. In many of the 'official' post-mortems of the financial crisis (Financial Services Authority, 2009e; Larosière, 2009), the failure of regulation was cited as one of the numerous causes and in the UK in particular, the Financial Services Authority was criticized for the lack of attention it paid to prudential regulation at the time (Financial Services Authority, 2009e, p. 87). Deficiencies in the FSA's supervisory approach were also implicated in the failures of Northern Rock (Financial Services Authority, 2008b), RBS (Financial Services Authority, 2011a) and HBOS (Financial Conduct Authority & Prudential Regulation Authority, 2015). So, not only were the banks struggling with legitimacy, the regulator itself faced public and political scrutiny.

In the midst of the wider ideational, legitimacy and power shifts associated with regulatory change after the crisis, the work of banking supervision carried on, but with a fundamentally altered philosophy (see Chapter 3). Supervision of banks consists of multiple 'on the ground' interactions between firms and supervisory staff from the regulatory authorities. This chapter explores the dynamics of these interactions and especially how they changed in the period after the financial crisis.

There is a significant body of regulatory literature exploring the interactions between the regulators and the regulated (Ayres & Braithwaite, 1992; Baldwin & Black, 2008; Black, 2002b; Black & Baldwin, 2010; Braithwaite, 1995; Braithwaite et al., 1994; Braithwaite, Murphy, & Reinhart, 2007; Etienne, 2012; Gray & Silbey, 2011; Gray & Silbey, 2014; Gunningham, Kagan, & Thornton, 2003; Gunningham et al., 2004; Hutter, 1997, 2001; Kagan & Scholz, 1984; May & Winter, 2000; Parker & Nielsen, 2011). Important findings from these studies have demonstrated that compliance is negotiated in these repeated interactions and that through 'responsive regulation', regulators can develop more effective enforcement strategies (Ayres & Braithwaite, 1992; Baldwin & Black, 2008; Black & Baldwin, 2010). The interdependence between the regulators and the regulated has also been noted as both a cause for concern in terms of regulatory capture but also as positive, with trust-based, co-operative relations leading to more positive regulatory outcomes (McCaffrey et al., 2007; Pautz, 2009; Pautz & Wamsley, 2011; Smith, 2013).

This chapter contributes to the academic literature on regulatory interactions by examining how relationships between the banks and the FSA/PRA played out in relation to the increased politicization of banking regulation and the legitimacy struggles experienced by both the banks and their supervisors in the wake of the financial crisis. Firstly, the chapter describes the actors that participated in these interactions, emphasizing that neither the banks nor the regulator can be viewed as an undifferentiated whole. Secondly, the various types of formal and informal regulatory interactions are explained from the perspective of the research participants. The remainder of the chapter focuses on the changing nature of these interactions over time, drawn from the accounts provided by the interviewees and concludes with more general implications of these findings for regulatory theory and the implementation of banking regulation.

Regulatory interactions – the actors

Interactions between regulators and regulated organizations in a complex and heavily regulated environment such as financial services involve a vast array of actors. Chapter 5 demonstrated that in large and complex entities such as banks, responsibilities for managing regulation are often dispersed throughout the organization. The fieldwork data indicated that in some cases, attempts were being made to centralize the responsibilities for regulatory relationship management by creating new teams and hiring more senior personnel to perform this role. Despite these changes, however, multiple actors from both the regulator and the banks continued to be involved in various types of regulatory interactions.

The regulator

The focus here is on the prudential supervision of the UK banking system. From 1997 to 2013, this was the responsibility of the FSA. The Prudential Regulation Authority (PRA) was formed on 1st April 2013[75] and had assumed all prudential supervisory responsibilities at the time the interview data for this thesis was collected and therefore, this section describes the structure and actors from the PRA.

The PRA operated a model whereby banks that were considered to pose a higher risk to the stability and soundness of the financial system were assigned an individual supervisor or a team of dedicated supervisors[76] (Prudential Regulation Authority, 2014b, p. 13). Smaller, lower risk organizations were supervised on a portfolio basis, and did not have a named supervisor (Prudential Regulation Authority, 2014b, p. 37). Supervisors and supervisory teams were responsible for the day-to-day regulation of that firm, and acted as a conduit into the PRA's Prudential Policy and Supervisory Risk Specialist teams who could be called on to provide input on specific regulatory issues. The head of the supervision team for a bank was known as the Lead or Line Supervisor and was the primary point of contact for the supervisee bank. Where a bank had several large divisions, each of these was also likely to be allocated a dedicated supervisor who reported to the overall Line Supervisor. The Prudential Policy team was responsible for setting regulatory standards in the UK and for liaising with the EU and international standard setters (such as the BCBS) on the making and implementation of prudential regulations. The Supervisory Risk Specialist directorate comprised deep technical experts in various risk disciplines (such as credit risk, market risk, liquidity risk) who supported the supervisors to analyze prudential risks and banks' risk management models and practices. So, depending on the topic in question, individuals in banks might encounter representatives from more than one area of the PRA.

[75] As described in Chapter 3, the FSA had been restructured into prudential and conduct business units in advance of the creation of the PRA and the Financial Conduct Authority and had been operating on this basis since April 2011

[76] The PRA continued to use the 'risk-based' approach to assigning supervisory resources that had been followed by the FSA (Ferran, 2011; Financial Services Authority, 2006a)

The banks

Within the banks, the picture was similarly complex. As shown in Chapter 5, the interview participants were employed in different roles and in different areas of their respective banking organizations. Some participants were directly responsible for managing the relationships with the regulator, whereas others did not encounter the regulator at all as part of their day-to-day activities. Chapter 5 also argues that the employees who were in organizational roles that were specifically aimed at managing regulatory relationships or were responsible for other aspects of regulatory management were 'internal representatives' of regulatory logic (Pache & Santos, 2010). Therefore, this chapter assumes that where those actors are involved, regulatory logic frames these regulatory interactions.

Those responsible for managing the supervisory relationship liaised closely with their counterpart at the PRA, the Line Supervisor and acted as a gatekeeper to other parts of the banking organization. The frequency with which the other respondents interacted with the regulator varied and this is shown in Table 6.1. In addition to their experiences with the supervisory teams, interview participants described interactions with the PRA's risk specialist and policy teams, depending on their role. For example, those with an advisory role tended to be in contact more with the PRA policy teams than the PRA supervisory team whereas those in a senior risk management role were likely to encounter the PRA supervisory team more frequently.

Table 6.1 Regulatory interaction frequency of interview participants

Bank	Total No. Interviewees	Responsible for Regulatory Relationship	Interact Frequently (> 4 times per year)	Interact Infrequently (< 4 times per year)	No interaction
A	12	1	5	4	2
B	2		2		
C	2	1	1		
D	5	1	3	1	
E	1		1		

Interview respondents indicated that there was some variance in the nature of their regulatory interactions according to two key factors[77]. The first was the seniority of the representatives from the PRA and the second was the PRA team within which they worked. Nearly half of the interviewees mentioned that they had difficulties in dealing with more junior members of PRA staff, explaining that these less experienced individuals tended to have a more rigid approach. Similar observations regarding younger or more junior regulatory staff have been found in previous studies of regulatory enforcement (Hawkins, 1984; Hutter, 1997). One respondent described how 'some of the junior ones like to be seen to be tough in front of their bosses' (Participant 12, 2014). Whilst demonstrating some empathy for the more junior PRA staff, the interviewees suggested that they 'asked really stupid questions of really senior people' (Participant 18, 2014). It was evident that the bank staff found these interactions frustrating and regarded them as a barrier to the PRA making decisions on important issues. Another consequence was described by this interviewee:

> *'you get some junior people [from] there [the PRA] who are not particularly impressive, then what happens is that the Group Chief Risk Officer stops coming and you get a CRO meeting where the CRO isn't there and it's me or somebody else.' (Participant 8, 2013)*

Sending junior members of PRA staff to meet with senior executives from the bank, as in this case, appeared to alienate the latter. However, it is not clear from the data whether this was a common occurrence as several respondents mentioned that there was a level of 'seniority matching' (Participant 12, 2014) whereby, in a particular interaction, the personnel from the PRA and the bank would be roughly at the same level of seniority.

The second key determinant that could affect the nature of the regulatory interaction was the team for which the PRA employee worked. According to several respondents who were closely involved in changes to regulatory risk models, the staff from the PRA's risk specialist teams had a tendency to be what respondents described as 'unreasonable' (Participant 3, 2013) or 'pedantic' (Participant 20, 2014):

[77] These two factors appeared to have the same level of significance for the interviewees from 2008 onwards but no comparison to the pre-crisis period was offered during the interviews

> *'obviously as a result of models being bad [the PRA] have responded accordingly so reduced interaction, reduced guidance, an observation of "we're not going to tell you how to do this, we don't have the resources to do that anymore and we've been told not do that anymore so you work it out and you come to us and we'll tell you whether you're right or wrong"' (Participant 3, 2013)*

In contrast, the PRA's Line Supervisors were perceived as being more 'pragmatic' (Participant 3, 2013) which the respondent below attributes to 'self-interest':

> *'Line supervisors at least had in their self-interest sometimes to be pragmatic. Ultimately they were the only ones that had an interest in an organization getting things done because they were associated with that.' (Participant 1, 2013)*

Whilst it is not possible to determine the claim to self-interest without gathering data from the PRA, it is likely that supervisors were identified more closely with the firms that they supervised than the other teams within the PRA because they had the ultimate responsibility for these relationships and were interacting with the firms they supervised on a more frequent basis.

The multiplicity of actors involved in regulation within an organization such as a bank could encourage what one interviewee described as a 'fishing expedition' (Participant 1, 2013) whereby they 'get a scattergun approach from them [the PRA] quite often…they ask the same question of a number of areas' (Participant 6, 2013). The dilemma this presented to the banks was that 'if you ask the same question to ten people and then spot two people who said something different, then the PRA will go back and challenge' (Participant 18, 2014). According to this respondent, differences arose not necessarily because the answers provided to the regulator were wrong but because different actors used different language to express the same thing or only had one particular view of the data. Accordingly, the respondent claimed that the PRA, however, perceived these differences as indicative of a problem, even when there was not one. Of course, there may also have been occasions where substantially different answers received from different parts of the organization were indicative of more serious failings so despite the banks' frustrations at this supervisory practice, it is unlikely that the PRA will stop using it.

Types of regulatory interaction

Regulatory interactions took many forms, as reported by the research participants – both formal and informal. These included face-to-face meetings, official letters, e-mails and telephone calls. This section examines these formal and informal interactions, bearing in mind that the information here represents a snapshot view from the time of the fieldwork, though there is also evidence that the nature of these interactions changed over time (see below).

Formal interactions

Previous studies that examine regulatory interactions (Hawkins, 1984; Hutter, 2001; Pautz, 2009; Pautz & Wamsley, 2011) have tended to focus on the repeated face-to-face interactions between the regulator and the regulated that typify inspection based regimes, such as health and safety or environmental protection. Whilst banking services regulation also requires the supervisors of regulated entities to meet with representatives from regulated organizations, the very nature of banking and prudential regulation means that there was very little that is tangible to inspect. The evidence of compliance, particularly with prudential regulation, often resides within technology systems which contained complex mathematical models to measure risks. Prudential regulators such as the PRA, therefore, are reliant on the output of these systems to assess the soundness of individual financial institutions and system-wide risks. From its inception, the PRA ran a continuous programme of risk assessment[78], the intensity of which depended on the size, nature and complexity of the bank (Prudential Regulation Authority, 2014b).

As part of this process of continuous assessment, the PRA held a cycle of scheduled meetings with actors from the banks who were deemed to be Approved Persons in Significant Influence (SI) functions[79]. The SI functions included Directors, Non-Executive

[78] Before the FSA was split into the PRA and the FCA, this continuous risk assessment was known as ARROW and the meetings with senior executives were described as 'close and continuous' (Financial Services Authority, 2006a)

[79] This framework was replaced in 2015 by the Senior Manager's Regime, and the continuous assessment process is now conducted with individuals classed as Senior Managers which includes but is not limited to CEO, the CFO, the CRO, Heads of Key Business Areas, Head of Internal Audit and the Chairman (Prudential Regulation Authority, 2015d)

Directors, Heads of Compliance, Money Laundering Reporting, Systems and Controls (e.g. Finance and Risk) and Customer Dealing. Of the interviewees in the sample, only two people who held senior risk management positions participated in this type of meeting. One of these respondents described these meetings as covering both general topics and 'separate deep dives into specific topics' (Participant 19, 2014) and gave the example that the PRA might want 'to look at what we're doing if we're starting to grow [a particular area] of business' (Participant 19, 2014). This respondent also described the need to remain flexible in these meetings, saying that:

> *'I don't do an awful lot of prep, because I think actually, in my role I should naturally be able to talk about these things.... If I felt I had to go thoroughly prepped for every time I had a conversation with the regulator, I'd actually be challenging myself: ... do you actually know your job well enough?' (Participant 19, 2014)*

Formal face-to-face meetings were also held for other purposes, often focusing on a particular set of issues identified by the supervisor as part of this ongoing assessment process. For example, in one bank there were two teams – one at Group level and one at Divisional level – both responsible for the bank's prudential risk models. These teams held regular meetings with the PRA specifically about topics related to the compliance of these models. Those meetings would typically involve not only the Line Supervisor from the PRA but also members of the PRA's Risk Specialist teams.

In other instances, the PRA might be conducting an in-depth thematic review of a particular set of products or line of business, which would involve 'discussions with staff, reviews of internal documents and some testing' (Prudential Regulation Authority, 2016a, p. 53). Other topics that interviewees mentioned as being on the agenda in meetings with the PRA included stress testing, Pillar 2 supervision (see Chapter 3), regular reviews of the market risk models and outputs, and cross-industry working groups to discuss specific regulatory matters such as risk data aggregation[80] and prudential rules for securitization. Finally, a respondent from Bank 1 described a day of meetings in 2013 to which the bank had invited several of its supervisors from different

[80] This was in regard to the implementation of the BCBS paper on Principles for Risk Aggregation and Risk Reporting (BCBS, 2013d) which concerned the banks' ability to centrally combine their risk data to get a single view of their exposures to risks across the whole organization.

jurisdictions, with the aim of making sure that the regulators understood the business model and complexities of the organization:

> *'we have a day for the regulators so they come into London, we have a programme for them. They say well, we'd like to spend time with the following people since we are in town. We usually start the day with a breakfast meeting with the Chief Executive…and then the day proceeds after that, they will then go and meet different people across the bank' (Participant 12, 2014).*

Thus, according to the interviewees, the reasons for the meetings with the PRA were wide-ranging and could be initiated by either the bank or the PRA, though the latter appeared to be more common.

Prior to the meetings, the PRA was required to send an agenda, which was often accompanied by a request for written information and/or numerical data to be sent to them in advance. In all the organizations in the sample, the receipt of this agenda was the trigger for two key preparatory activities - the creation of the materials for discussion in the meeting and the briefing of the staff that were to attend the meeting (see below). Both these activities were usually overseen by the Regulatory Affairs team with input from the subject matter experts in the wider organization.

Formal meetings with the regulators were always attended by representatives from Regulatory Affairs in addition to those from other areas of the organization. Minutes from these meetings would be taken for internal purposes only, as the PRA would not accept or sign-off on these, providing their own summary of the meeting afterwards in a formal letter. These letters would cite the PRA's perspective on the meeting, any decisions that had been made and any ensuing concerns that still required resolution. One notable aspect of these letters was described by four participants, which was the difference between the tone of the meeting and that of the written communication:

> *'They can be perfectly nice in the meeting and they can come back and absolutely eviscerate you in a letter' (Participant 17, 2014).*

One of the interviewees speculated about the reasons for this:

> *'there was always a close-out meeting and a verbal feedback. Of course, they then take that - their thesis, if you like, to a [PRA] committee, their recommendations to a committee. [The PRA Decision] Committee always ratchets everything up, and it'll look*

at the letter, and say: you need to toughen up the letter. And therefore there's a big jump between the last little bit of verbal feedback you've got, and when the letter comes it's always a bit harder and starker' (Participant 18, 2014).

Formal interactions with the regulator, therefore, appear to follow a particular protocol which was understood by those on both sides of the interaction. From the PRA's perspective, these meetings and formal correspondence were the key mechanisms for obtaining information, assessing risks and providing feedback to the firms. For the banks (and particularly after the crisis as discussed below) they required significant preparatory work but were also an opportunity to educate the regulator about the organization.

Informal interactions

As might be expected, in addition to the more formal face-to-face or written communications outlined above, interviewees also described continuous, informal engagement with their line supervisors. The nature of these communications was more open-ended, in some instances it was purely administrative – scheduling meetings, checking receipt of information, following up on queries or seeking clarification on others. Such interactions included regular, weekly telephone calls to check on progress on particular issues:

'There's no agenda, we just say what's been happening this week, and it's a valve for things that they're concerned about or things they've spotted or things they don't understand or things that we're fed up about. You know, we can just literally call it how it is.' (Participant 18, 2014)

In other instances, however, the lack of prescription in these communications allowed the regulatory liaison officers and the line supervisors to use them more strategically.

In one case, a respondent described a situation where the line supervisor had raised a concern to him informally regarding an uncooperative bank employee.

'I can take that away and say … is it perception, is it reality? If it's perception, and often it can be, it's just you know we need to be more careful with the style of communication. Or actually, do you know what – you two need to get together more so that you understand [each other better].' (Participant 18, 2014)

Similarly, this interviewee describes how, if someone in his banking organization had a difficult meeting with a specific person from the PRA, he would try to resolve it by

> *'picking up the phone to the supervision team, usually one of the senior ones and say, look, I heard about a meeting yesterday that didn't go terribly well, because of X & Y. What did you think of that, what was your impression of that meeting? Could it have been better, could we have got a better outcome?' (Participant 12, 2014)*

These quotes are both taken from individuals who have primary responsibility for the relationship with the regulator, they were both keen to resolve any concerns that arose in regulatory interactions. This 'behind the scenes' work to smooth out tensions in regulator-regulated relationships echoes the regulatory literature which suggests that co-operative, constructive relations are sought by those on both sides of the interaction (McCaffrey et al., 2007; Pautz, 2009; Pautz & Wamsley, 2011; Smith, 2013). From the regulator's perspective, maintaining a co-operative stance is likely to result in more effective supervision and regulatory outcomes. From the banks' perspective, the reasons are articulated by this respondent:

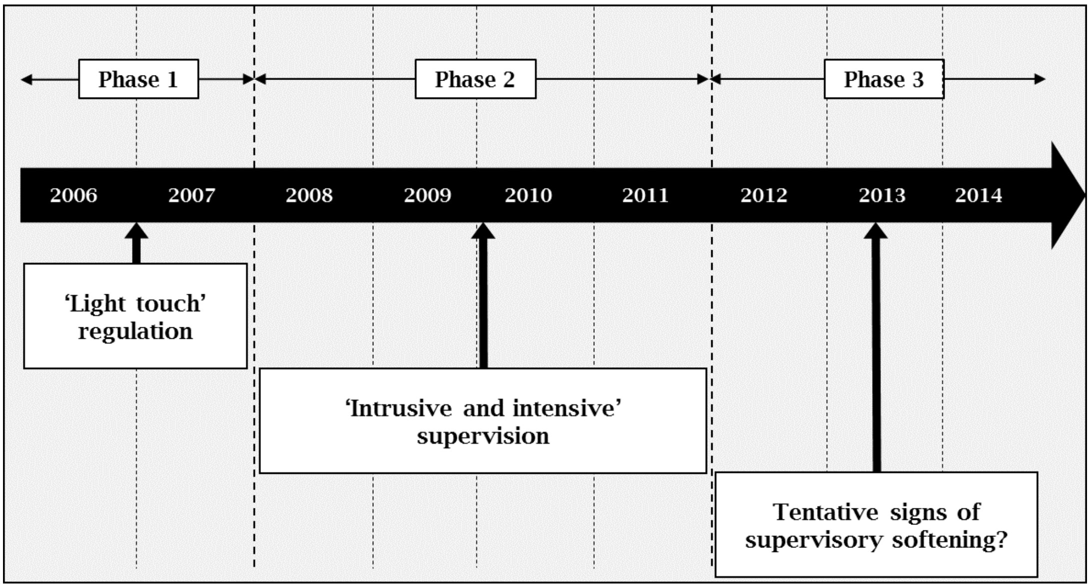
> *'So we both [bank and PRA] want the bank to be successful, we do want it to make a profit, we are a commercial institution, we want it do the right things by its customers, we want the business to be sustainable over the long run, we want to be trusted again, we want to be respected in some respect. And we want to be conservatively and soundly and prudentially managed, right? So they are the sort of things that we care about. So if you are talking to the supervisor, he will say these are the things that as a regulator, we want too. The difficulty comes a little bit on what is the path to get to some of those things' (Participant 12, 2014).*

Dynamics of regulatory interactions from 2006 - 2013

The fundamental need for regulatory interactions does not change over time because they are the primary means through which the regulator can determine compliance and, in the case of financial services regulation in the UK, assess the risk of individual firms to the regulatory objectives. However, as with all relationships, the analysis of the interview data revealed that there was also a dynamic aspect to these interactions which cannot be separated from the wider political and economic context within which they are conducted. This section therefore explores how the nature of these interactions between the regulated banks and their prudential supervisors changed between 2006 and 2013[81]. This is a critical component of regulatory change, and while less tangible than changes to the regulatory rules it nevertheless requires a particular set of skills, practices and structures to be managed effectively (see Chapter 5).

In coding the interview data, three distinct time periods emerged, each demonstrating a difference in the nature of the supervisory interactions as illustrated in Figure 6.1. Firstly, several (but not all) respondents described the style of regulatory supervision prior to the financial crisis. This stage has been labelled 'light-touch regulation' and ran from 2006 – 2008. The second stage, from 2008 to 2012 was most frequently discussed by the interviewees and was characterized by more 'intrusive and intensive' supervision. Finally, there were some respondents, primarily from the same organization, who claimed to have observed some softening in the supervisory approach from roughly the end of 2012 onwards[82].

Figure 6.1 Changes in regulatory interactions 2006 - 2013



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[81] Among the interviewees, there was some variance in terms of the length of time they had occupied their organizational role. In instances where they had been incumbent for only 2-3 years, observations relating to 2006-2012 were limited. A number of interviewees who had been in the same role for a number of years also discussed supervisory interactions prior to the financial crisis, hence this time period. The timeframe 2006 - 2008 is included as interviewees also offered their opinions of regulatory interactions prior to the crisis.

[82] Whilst these three phases may seem similar to those identified in Chapter 4, it should be noted that in both cases, the chronological periods were derived inductively from separate data sets and that no causality or relationship between them is implied.

Phase 1 (2006 – 2008) – 'Light touch regulation'

In the ten years between its inception in 1997 and the failure of Northern Rock in 2007, the FSA oversaw banking during the 'great moderation' (Stock & Watson, 2003). As Chapter 3 described, the approach adopted by the FSA to bank supervision was non-interventionist, risk-based, 'proportionate' and based on the assumption that the markets were self-correcting and that the banks' senior management would act responsibly to ensure their firms were prudently managed (Financial Services Authority, 2000, 2003, 2006a, 2007). This style of regulation was referred to by the epithet of 'light-touch regulation'. It is not surprising, therefore, that respondents also recalled the FSA supervision of their banks at this time as being 'light touch'. Indeed, Table 6.2 shows how various respondents described these 'collegial relationships' (McPhilemy, 2013) with their supervisors.

Table 6.2 Interview participants' descriptions of FSA supervision prior to 2008

Description	Source
'regulators were there but didn't need any careful attention'	Participant 12
'extremely benign'	Participant 12
'very, very light touch'	Participant 12
'cosy fireside chat'	Participant 19
'partnering the banking system rather than a watchdog'	Participant 20
'soft-touch approach'	Participant 20
'laissez-faire'	Participant 21
'regulatory affairs was a sleepy backwater'	Participant 22

As a result of these perceptions, the FSA was not considered a particular threat and thus bank staff did not dedicate much time or effort to managing their relationships with the UK regulator:

> *'It was partly because the bank probably didn't think regulators were that important, they knew they were there. You know, the market, London following the Big Bang, quote "the City will self-regulate" unquote. So regulators were there but didn't need any careful attention. That's very much different now.' (Participant 12, 2014).*

When banks did pay attention, this respondent continued, there was considerable resistance to regulatory requests:

'In the old days, the attitude was very much tell the regulator to go away, stop bothering us, why do they want that bit of paper, tell them they can't have it, you know, push back quite a lot.' (Participant 12, 2014)

This ability to 'get away' with pushing back on the regulator was perhaps one indication that the balance of power often lay more with the banks than the supervisor. Asymmetries in information and expertise also signified a power imbalance, weighted in favour of the banking organizations, resulting in the type of situation described by this interviewee:

'You'd have had the front office person just phoning up the regulator when they felt like it because they could…. the regulatory staff, because they didn't know as much, they would treat our Front Office as gurus and therefore the relationship was skewed that way.' (Participant 2, 2013).

In terms of the substantive nature of the regulatory interactions at this time, one interviewee described how they were either focused either on conduct issues or the technical aspects of Basel 2 risk models (see Chapter 3):

'Well, 2006/7, it was very laissez faire. The impression you had is that the FSA had a conduct agenda and didn't really have a regulatory agenda in the capital space, or in liquidity. So really, they saw themselves as the consumer champion...And you knew that they were worried about sort of customer treatment, but you were sort of graded on the basis of the way you dealt with your customers, not the risk you were running or how capitalised you were.….The FSA were very purist. There was a lot about the purity of the models. It was a very sort of technical approach' (Participant 21, 2014)

The FSA's focus on conduct of business regulation at the expense of prudential regulation was also a finding from the FSA's investigation into the failure of RBS which states that:

'A significant amount of Supervision management time was spent on conduct issues, for example Treating Customers Fairly (TCF), at a time when the prudential risks faced by firms were increasing. This approach also failed adequately to foster the development of skills specifically focused on the prudential risks of capital, asset quality, balance sheet composition and liquidity' (Financial Services Authority, 2011a, p. 259).

Similarly, the more recent examination of the failure of HBOS reported that

'The process of assessing and validating Basel II models absorbed a very significant proportion of the FSA's specialist prudential risk resource during 2006 and 2007.' (Financial Conduct Authority & Prudential Regulation Authority, 2015, p. 256).

Despite the potential bias in these reports (driven by an understandable desire for the FSA and then the PRA / FCA to exonerate or minimize the blame attached to themselves), they do also give a flavour of the political climate at the time. The continual political rhetoric about 'light-touch' regulation, these reports claim, constrained the regulator's ability to intervene more forcefully in the banks activities such as scrutinizing bank business models (Engelen et al., 2012; Johal et al., 2014). Indeed, when Prime Minister Tony Blair publicly criticized the FSA for 'inhibiting efficient business' (Blair, 2005), the then Chairman of the FSA, Callum McCarthy wrote a letter in response, stating that:

> *'When the FSA embodies so many of the principles you are advocating, it is both perplexing and frustrating to be described as an inhibitant to efficient regulation. We fully support your desire to see regulation develop in a more common sense, risk-based way, with proper consideration of proportionality, costs and benefits' (McCarthy, 2005)*

The degree of political restraint placed on the regulator was also commented on by an interviewee who described a situation in 2006/7 where the FSA had allowed them to structure a transaction in a certain way so as to attract a lower regulatory capital requirement. A similar request in 2009 was refused.

> *'The first time round, I thought these guys are idiots. They are just sitting there and we're pulling the wool over their eyes and they're just letting it happen and they probably don't even understand the issue. Course they understood the issue. They really did. And after the crash, they were enabled by their management to articulate the fact they understood the issue and that they didn't approve of it. So in a way, they were unleashed from this sort of repression that they lived under, the sort of soft-touch approach' (Participant 21, 2014)*

In this example, the on the ground interactions reflected the pressures and tensions in the wider political environment, affecting not only determinations of compliance but also how those in the regulated organizations perceived and constructed their opinions of the regulators.

Phase 2 (2009-2010) – more intrusive and intensive supervision

As noted above and in Chapter 3, political and public sentiment towards the banking sector changed substantially in the immediate aftermath of the crisis. The disbanding of the FSA and the creation of the PRA and the FCA was typical of the 'restructuring' strategy used to repair legitimacy (Suchman, 1995) and demonstrated an approach to bank supervision that was 'less box-ticking and more exercise of judgement' requiring 'an intimate knowledge of what is happening in individual firms' (HM Treasury & Osborne, 2010).

From the perspective of the banks, these shifts in supervisory style was not merely rhetorical, resulting in a noticeable change to regulatory interactions, described by the respondents in the terms depicted in Table 6.3.

Table 6.3 Terms used to describe change in supervisory approach (2008 onwards)

Term	No. of References	No. of Sources
Intrusive	13	6
Robust	6	2
Challenging	3	3
Demanding	3	3
Tougher	3	3
Assertive	3	3
"have more teeth"	2	2
Intensive	2	1
Serious	1	1

The interview participants described how this tougher mode of regulation manifested itself in four key changes to their regulatory interactions. First, there was an increase in the level of regulatory communications, in terms of frequency and quality, bolstered by the increasing size and greater skills of the supervisory teams. Second, the regulator was demanding more information from the banks. Not only was a greater volume of data required, the scope of that data was wider and deeper than before, encompassing 'everything from the balance sheet to the assets we put on the balance sheet, and how we run things, capital, liquidity, funding, risk management' (Participant 12, 2014). A third, more subtle change was exhibited by the change in tone in regulatory meetings. These interactions were described as 'more formal' (Participant 6, 2013; Participant 17, 2014), 'less friendly' (Participant 13, 2014) and even a 'bit stiff' (Participant 18, 2014). In fewer and more extreme cases, relations had soured to the point that 'the tone of the meetings was very hostile indeed, more so the more senior the person' (Participant 10, 2014). Others described their engagement with the regulator as harsh, tense or uncomfortable without being overtly hostile. Finally, the regulator's tougher stance was revealed in the FSA and then PRA's lack of willingness to enter into dialogue in terms of providing *ex ante* guidance, rule interpretation advice or wider consultations with the industry[83].

Young (2013) reports similar findings in his study of the post-crisis lobbying activities of financial trade associations. He describes how lobbyists struggled to get the same level of access to policy-makers in international fora as they had previously experienced. An example of this occurred in December 2013, when Michel Barnier, the European Commissioner responsible for overseeing banking reform banned all meetings between bank representatives and his staff (Wilson, 2013). In addition, in parallel with the findings above, Young found that the style of interactions changed:

> *'dialogue between regulators and financial industry groups not only became more formal and more restricted, but financial industry groups learned of new policy changes at a much later stage than they had in the past' (Young, 2013, p. 463)*

Despite this apparent one-sidedness in regulatory discussions, the banks were not passive participants in these interactions. On the contrary, some banks, (or teams or individuals within banks) actively sought to change the nature of these interactions via a number of mechanisms. Such mechanisms included the types of structural changes described in Chapter 5, such as the creation of teams specifically to manage regulatory relationships, headed by ex-FSA staff. Other, more subtle signifiers of an attitudinal change were apparent in the reduced resistance to regulatory decisions and requests, the increased level of scrutiny the banks paid to the materials and information they shared with the regulator, and more careful consideration and planning in advance of regulatory meetings. As this interviewee describes, banks were a lot less likely to challenge the regulator:

[83] The FSA and PRA still complied with their statutory duty to issue consultation papers, but one respondent described this a 'they tend to be making statements and it might be called a consultation paper but it's not, this is how it's going to be' (Participant 3, 2013)

'It is slightly different for every firm in terms of how assertive they can be, but there's definitely a change in the balance. I went to a round table at the PRA earlier this week so you see all the firms and you can have lots of bilateral conversations but you do have a few panels like that and there isn't a lot of push back to things that the regulator is asking for even though they are being a lot more demanding' (Participant 8, 2013)

Responses from the interview participants suggested that the preparation of regulatory materials to be sent in advance of the meetings or discussed during the meetings was given considerable attention. In terms of the formal meetings, nearly all the respondents[84] who attended such events said that they prepared written materials in advance:

'We go with a lot of paper. Generally, it's sort of getting well prepared. We had quite a good meeting with them when they wanted to understand the results, so we got together a couple of colleagues, who are really involved in the MI [management information] side, and they wanted to know quite a lot about business drivers. And we went with a detailed deck of information and they loved it' (Participant 21, 2014)

Another interviewee described how these materials were of the same presentational standard they would use for client meetings. Others emphasized the need for the information contained within to be accurate, with any underlying assumptions explained clearly and consistently. On occasion, the meeting materials would be created by people who were not going to attend the meetings. In these instances, the regulatory liaison teams would provide direction as to the style and content of the presentation:

'We were given some guidance from the team that interacted mostly with the regulator as to these are perhaps things that you might want to make sure are in the pack or make sure you mention these particular aspects because that is what the regulator would ask about so if you could include it in the pack in advance that would be helpful.' (Participant 9, 2013)

Those organizational members that interacted most frequently with the regulator were responsible for ensuring that the information taken to regulatory meetings was appropriate.

'So invariably, the modelling teams will put [the presentation] together, and they are very smart and very good and some are good at communicating. And then we'll do a

[84] There were two exceptions to this, interviewees who tended to meet with the PRA as part of the Continuous Assessment Programme. They both felt that it was part of their role and level of seniority to be able to answer the regulators' questions without having to do a lot of advance preparation (Participants 20 and 21).

review with the team, with us to go through and go okay, is this the right message. And sometimes they are being a little bit pointy and they think that the PRA continues to make silly decisions as far as their models are concerned and I get that because they are modellers and they want their models to be 'pure' and 'beautiful' as they call it sometimes.' (Participant 3, 2013)

Representatives from all five banks in the sample stressed their objective was to be open and transparent with the regulator, and that providing them with plenty of information about their organization was one way to achieve this.

'It's a requirement to get information so they can understand what's going on in the business that they don't live and breathe on a daily basis so it's only natural that some of the more complex areas are going to need review and challenge and follow up.' (Participant 5, 2013)

Underlying this co-operative sharing of organizational knowledge, however, was another motive. Several respondents reported that they felt that the regulator demonstrated a lack of understanding of their business, which manifested itself in asking what the banks deemed as the 'wrong' questions or becoming very pedantic about minor issues. To overcome this or to 'steer' the regulator in the right direction:

'We make sure we do a lot of talking and we give them a lot of information. But that requires constant monitoring, I would say. You can't rely on it, and it doesn't happen by magic, and we have to be helpful, we have to offer to bring them in to look at things, and teach them, and help them to be better.' (Participant 18, 2014).

In constructing the responses to ad hoc information requests (which generally tended to require numerical data, such as credit risk exposures for a particular type of customer), the respondents emphasized that their priority was to provide complete and accurate data, rather than ensuring the information contained a particular message or messages:

'Message management - much more basic is it actually in a state fit for the objective in itself. That's not necessarily management, there's something slightly negative about message management. The review is actually is it accurate or can you put everything into words. If you can't well is it actually sufficiently accurate to give an appropriate description of what is happening on the ground.' (Participant 1, 2013)

This assertion was reiterated by this interviewee from a different bank who, as part of his role, was responsible for signing-off on information request responses before they were sent to the regulator:

'I'm far more worried about the content being accurate and appropriate than I am about the language.' (Participant 17, 2014)

Preparing or briefing staff to meet with the regulator also appeared to be taken seriously by the banks in the interview sample. Employees who were briefed ranged from more junior employees who are not usually involved in such interactions through to the most senior members of the organization. Ahead of the scheduled meetings, preparatory materials would be produced and discussed in pre-meeting briefings:

'My team would write up the briefing, so the briefing would be written, … sent to the Chairman a few days in advance. I'd go and see the Chairman ahead of it and say is there anything you want to discuss, anything we should go over, anything that isn't clear, and then the meeting itself.' (Participant 12, 2014)

In addition to these written briefs (which tended to focus on the substantive content of the meeting agenda), respondents described how they coached their colleagues in the 'softer' aspects of behaviour in meetings with the regulator. This unwritten 'code of conduct' included communicating clearly and concisely, not answering questions if the employee did not know the answer, not bringing in papers to the meeting that staff member would be reluctant to share with the supervisory staff and treating the regulatory personnel with professional respect and courtesy (Participant 9, 2013; Participant 19, 2014).

The respondents also described how they were careful about *who* was meeting with the regulator. In one bank, there was a formal regulatory contact policy, 'which sort of sets out some ground rules and it lists those people who are acknowledged as being people who can speak to the regulators' (Participant 18, 2014). In other organizations, there was not such a formal approach but nevertheless, there was a degree of mindfulness about the most appropriate people to meet with the regulator:

'We also changed who the regulators were meeting with and who was preparing the information. It used to be very technical people, the quantitative people responsible for the methodology or the IT systems people but we needed to communicate in a way the regulator could understand and also to frame the documentation appropriately and professionally.' (Participant 10, 2014)

Another respondent describes how the bank itself had become more guarded and more formal in the management of the regulatory relationship over this period but that this had not happened as part of a formal edict. Rather, it was more of an implicit understanding that ‘we are going to be more careful with the regulator’ (Participant 17, 2014). Not only did this manifest in the formalization of communications on behalf of the bank, the organization also hired an ex-regulator to act as the ‘gatekeeper’ between the bank and the supervisor. This need to be ‘more careful’ with the regulator could be viewed as a direct reaction to the tougher supervisory stance but the data shows that there was also a realization on behalf of the banks that in the post-crisis context, they had less ‘political capital’ and even perhaps credibility and had to pay more attention to their supervisors.

In their discussions of the relationships with their regulatory counterparts, the respondents displayed a fairly sophisticated level of understanding of the FSA/PRA[85] as an organization. These observations were not limited to interviewees who had previously worked for the regulator, and included respondents who generally had fewer dealings with the supervisory team. Respondents recognized that their supervisors were also operating in a challenging environment and that this might have a bearing on their regulatory interactions:

> *‘We understand that the regulators have a lot of political pressure being put on them to actually prove that they are doing their jobs properly and I think that does come out in terms of those discussions and the points we see being pushed back to us in various technical or close and continuous reviews on points which we might see as being fairly pedantic.’ (Participant 5, 2013)*

In addition, several respondents suggested that the internal culture of the FSA/PRA provided some constraints on how the supervisors were able to interact with the regulated organizations:

> *‘the people that we deal with at the PRA, it’s not their idea, and they don’t have the freedom to navigate away from it, they can interpret a bit, the breadth but the*

[85] Despite this understanding, interviewees usually referred to the FSA / PRA as just ‘the regulator’ and did not often make a distinction between the two organizations. This was largely due to the Lead Supervisors and other supervisory staff comprising the same individuals after the PRA was created.

> *fundamental kind of objective is being imposed on them as much as it is on us and to be honest it's, you've got to see the bigger picture' (Participant 8, 2013)*

Finally, as this participant explains, the less tangible aspects of the interactions are analyzed on both sides of the relationship which will then inform their next interaction:

> *'Every time they see you they're judging you. Every time, every interaction is a judgement, and everyone needs to remember that. Just as we - we do the same. They walk in the door and when they leave we talk about them. You analyse everybody. They're doing that. The difference for them is that of course they take it away and it informs their supervisory strategy.' (Participant 18, 2014).*

These perceptions of the culture and working practices of the FSA/PRA, whether accurate or not, demonstrate how actors from regulated organizations construct a picture or identity of those who regulate them. Gray and Silbey (2014) discovered that organizational 'actors continually engage in interpretive processes concerning the relevance, competence, and power of regulators as they assess what constitutes compliance with governing norms' (Gray & Silbey, 2014, p. 99). Such interpretive processes in this case gave rise to varied descriptions of the regulator such as 'asking more challenging questions' (Participant 3, 2013), 'they are being more demanding' (Participant 3, 2013), 'they do struggle getting in enough good people' (Participant 21, 2014), 'some regulators can't quite distinguish between being tough and actually being slightly rude' (Participant 21, 2014).

Actors within the banks experienced a more intrusive supervisory approach, manifested in increased levels of contact and more demanding questions. This led to a (re)construction of the identity of the supervisors from the FSA/PRA as being tougher and having 'more teeth' than previously. In response, bank staff more deliberately constructed information and meeting materials and paid more attention to the behavioural aspects of face-to-face interactions. This in turn can be construed as bank actors working to construct an identity for their organizations, an identity derived from the institutional logic of regulation – a 'regulatory identity'.

During this second stage, then, there were significant shifts in the nature of the regulatory interactions. A tougher, more assertive stance on behalf of the regulators was met by an increase in co-operation and more deliberate construction of regulatory information by the banks. Increased formality on both sides of these interactions meant that greater preparation was required and more thought given to who should be involved in these interactions. Whilst there is not enough data here to make strong claims, for the banks in the sample, it seems as if the motivation for doing so was to provide information that was correct, accurate and not misleading rather than presenting a particular version of the truth. It would appear that adaptations were being made in response to the 'relational signals' transmitted by the parties on both sides of the regulatory dyad (Etienne, 2012). This claim is provisional only, however, because the scope of the study necessarily excluded collecting data from the regulator.

Phase 3 2012 – 2014 – tentative regulatory softening?

A final shift in regulatory relationships was only identified by interviewees from one organization in the sample, though a handful of other respondents did remark on a continuing improvement in the relationship with their supervisors and greater levels of reciprocal trust. In this one bank, however, there were some tentative signs of regulatory softening in relation to two specific programmes of work dedicated to remediating specific regulatory problems.

Members of a risk management team in the wholesale division of this bank had experienced some very problematic interactions with the regulator. These concerned a Basel 2 internal risk model that had previously been approved but had then been determined to be non-compliant by the FSA (and then PRA)[86]. A member of that team describes how this relationship had improved since 2012:

> *'Over this two year period, that relationship has dramatically changed, actually to the extent that they've even allowed us now to turn on our models for our capital calculations' (Participant 4, 2013).*

He attributed this softening of relations partly to the actions that the team itself had taken over that period of time:

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[86] This was also indicative of the participants' observation that the PRA had tightened the interpretation regarding existing rules as well as implementing newer, more stringent regulations.

> *'There's actually a real distinct change in the trust level they have. They've looked back over the last two years and they can see that senior stakeholders were brought in, the programme lead was very serious about achieving what needed to be achieved and they've got a level of trust back that says okay we've seen how you do, we've seen how you've become that professional in doing it.' (Participant 4, 2013)*

In this case, the bank demonstrated substantive changes in response to issues raised by the regulator. Risk models were amended, senior management involvement was increased, the change programme received additional funding and engaged in a large programme of training and education. It is worth noting, however, that the benefits to the organization from all this work included a significant reduction in regulatory capital levels which once again raises the question of motivation and whether it is of concern that substantive changes are the result of actions driven more by market logic than regulatory logic.

So, at the end of the fieldwork period, for one bank at least, it appears that regulatory relationships were showing signs of improvement, implying some restoration of 'regulatory endorsement' (Suchman, 1995). This bank attributed this softening in part to the increased efforts they had put in to managing these regulatory interactions, and to their own changes in approach to the regulator. This lends further credence to the idea that adaptions occur during regulatory interactions and that active 'management' of a bank's regulatory identity can contribute to improvements in a bank's relationship with its supervisor.

However, this particular bank's experience appears to be unique, as none of the other interviewees described any concessions being made by the regulators. One possible explanation is that this final stage also coincided with revelations of financial misconduct such as the manipulation of LIBOR and foreign exchange rates. Such misdeeds contravened conduct of business regulation and thus were the responsibility of the FCA and not the PRA. Nevertheless, these events once again increased the political salience of the financial industry and the need for additional regulatory reform. Moreover, whatever work the banks were doing to repair their legitimacy could have been hindered by these very public scandals. In such a climate, it would be unlikely for supervisors to reduce their level of scrutiny.

Discussion

The examination of the regulatory interactions between the prudential regulator and the regulated banks presented here leads to three key arguments. The first argument is that there are multiple actors involved in these interactions and that the type and nature of these interactions can vary widely. The second is that by interrogating the day-to-day relationships between the regulators and the regulated, it is clear that such interactions are not immune to events in the wider political and social environment. Finally, the evidence with regards to the changing nature of regulatory interactions following the financial crisis indicates that through interpretive processes, actors participating in these interactions were actively constructing not only the identity of the regulator and particular supervisors, they were also engaged in actively constructing the regulatory identity of their own banking organization.

As Chapter 5 demonstrated, banks are highly complex organizations and responsibilities for managing different aspects of regulatory change are fragmented. At the same time, the PRA's continuous assessment programme and other thematic reviews require interactions with multiple actors within the banking organizations. In addition, the PRA itself consists of teams with varying types of expertise as well as the line supervisors, so formal meetings with banks may also be attended by policy or risk specialists. Variations in actors and reasons for regulatory interactions will obviously lead to differentiated experiences of these interactions. More problematically for the regulated organizations, however, it can result in inaccurate or misleading responses to questions because of the PRA's perceived 'scattergun' approach which in turn emphasizes the need for more centralized ways of managing regulatory communications. Those that are responsible for these interactions play an important role in smoothing over the tensions that can arise in regulatory relationships due to differing understandings, interpretations of information or other miscommunications. Their overriding aim here appeared to be promoting co-operative and constructive relations, adding credence to the claims that trust-based relationships can result in beneficial regulatory outcomes (Pautz, 2009; Pautz & Wamsley, 2011) but also suggesting that relationships on this basis also benefit the regulatees.

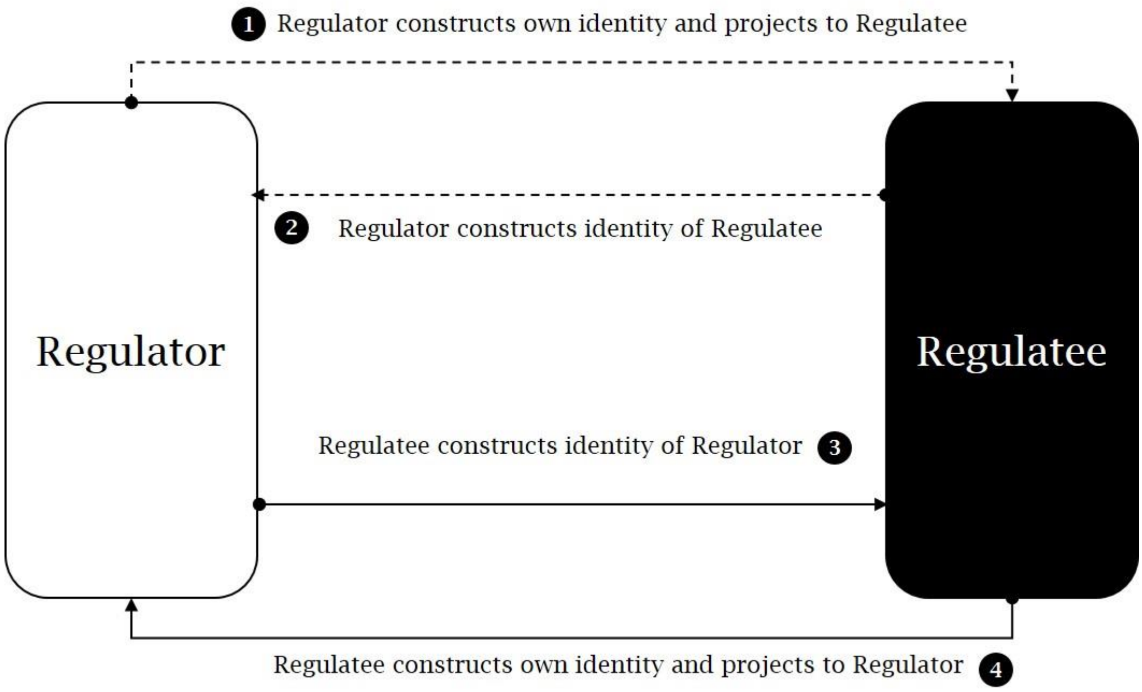
Having said that, regulatory interactions do not occur in a vacuum. Accounts of the changing nature of regulatory interactions since the financial crisis indicated the influence that the wider political environment had when banks and supervisors met. Indeed, the interface between the regulated and the regulator can perhaps be viewed as the arena where wider power and legitimacy struggles with regards to the financial industry and the state are enacted on a day-to-day basis. Before the financial crisis, in the era of the 'great moderation' and light-touch regulation, comparatively little time and effort was dedicated to managing regulatory relationships and bank employees may have perceived their organizations to have the upper hand in terms of expertise and skills. However, the increased political salience of regulation after the crisis created a situation where regulators had to be seen to be tougher on banks and despite interacting with exactly the same individuals as before the crisis, this was clearly evident to the bankers on the ground in their post-crisis regulatory relationships. In response to the increased supervisory scrutiny they were experiencing, actors within the banks began to pay more attention to their regulatory encounters, carefully crafting presentation materials and preparing staff for meetings. According to the interviewees, this was motivated by a desire to be open, transparent and honest, once again in the hope of developing co-operative and constructive working relationships. In one case, it seemed as if this approach had worked to rebuild trust with the regulator, manifested by achieving regulatory approval for a more advanced risk model that resulted in a lower capital requirement. However, there were limited signs of the supervisory approach softening in general, especially given the other examples of financial misconduct that emerged from 2012 onwards.

The final argument this chapter presents is that through these ongoing regulatory interactions which are influenced by events in the wider environment, actors within regulated organizations actively construct not only the identity of their regulators, but also the 'regulatory identity' of their own organization. Black (2002b) emphasizes the role that communicative interactions play in understanding the dynamics of the regulatory regime in general and the creation of identities in particular (Black, 1998, 2002b, 2008a).

> *'In relation to regulation, identity matters because it affects how individuals and organizations are viewed and thus responses to them, and because it affects action, for example, agenda setting or policy positioning.' (Black, 2002, p. 183)*

Analytically (and empirically in three out of four cases), Black suggests that there are four possible variants in regulatory identity construction within the regulator/ regulatee dyad as shown by Figure 6.2.

Figure 6.2 Regulatory identity construction flows



The first is that the regulator constructs its identity vis-à-vis the organizations that it regulates (1), as envisaged by responsive regulation (Ayres & Braithwaite, 1992), which supposes that the regulator will deliberately portray itself in a particular manner (such as a 'benign big gun') to influence the compliance behaviour of the regulated organization. Secondly, regulators will construct the identity of those they are regulating (2). Firms may be classified according to their perceived dispositions towards compliance with regulation. Various typologies have been offered either theoretically or as a result of empirical studies (Baldwin, 1995; Kagan & Scholz, 1984). Third, through their interactions with the regulator, regulatees construct their own understandings of the regulator. Gray and Silbey (2014) have identified three variations in how regulators might be constructed – as 'threat, 'ally' or 'obstacle'. Finally, regulated organizations (and the actors within those organizations) construct their own identity with regards to regulation (4).

Analysis of the interview data described above demonstrated that actors within the banks interpreted the conversations and non-verbal aspects of their regulatory interactions to construct identities of the bank supervisors and the PRA as a whole. These varied between organizational actors and between organizations but there is not enough data in this study to develop a systematic typology as per Gray and Silbey (2014). What is interesting here, however, is that bank staff make adaptions in relation to the identities of the regulator that they construct. If, for example, he or she considered that a particular supervisor did not have a good enough understanding of the bank's business, that bank employee would arrange meetings especially designed to educate the regulator. These adaptions themselves are a process of identity construction, but in this case, the actors within the bank are constructing the organization's own regulatory identity. Based on the descriptions provided by the interviewees, these individuals are hoping that the work they are doing projects a regulatory identity characterized by openness, trust, honesty, co-operation and a willingness to achieve compliance with the new regulatory rules, an identity commensurate with the organizing principles of regulatory logic.

Of course, the majority of the interview respondents occupied organizational positions where they were primarily responsible for keeping a check on the Front Office (such as Risk or Finance) or for managing regulatory change. Whether this commitment to fostering positive regulatory relations and institutionalizing a culture of prudential regulatory compliance persisted throughout the organization is another question and is addressed in Chapter 7.

Chapter 7: Institutionalization of prudential regulation?

Since the financial crisis, and the more recent catalogue of financial misdemeanors such as LIBOR and foreign exchange rate manipulation, the issue of culture in the financial industry has come to the fore (Future of Banking Commission, 2010; Parliamentary Commission on Banking Standards, 2013a, 2013b; Salz, 2013; Spicer et al., 2014). Whilst some of the focus has been on how to improve conduct and encourage ethical behaviour, there has also been a significant amount of attention paid to improving 'risk culture' within banks (BCBS, 2015; Financial Stability Board, 2014; Power, Ashby, & Palermo, 2013). The Basel Committee defines risk culture as:

> *'A bank's norms, attitudes and behaviours related to risk awareness, risk-taking and risk management, and controls that shape decisions on risks. Risk culture influences the decisions of management and employees during the day-to-day activities and has an impact on the risks they assume.' (BCBS, 2015, p. 2)*

Neo-institutional scholars would recognize 'norms, attitudes and behaviours' as significant cultural aspects of institutions (Thornton et al., 2012, p. 2), the persistence of which relies on the process of institutionalization (Zucker, 1977).

Accounts of institutionalization found in organizational theory (Jepperson, 1991; Tolbert & Zucker, 1999; Zucker, 1977) rest on an assumption that what is being institutionalized is stable and unchanging. However, investigating the possibilities for the institutionalization of prudential regulation and its underlying logic within banks must take into consideration the dynamic nature of the regulatory environment. As previous chapters have demonstrated, not only was there a raft of new prudential regulations, the regulatory architecture in the UK was overhauled, the supervisory approach intensified, supervisors raised their expectations of regulatory compliance and there was a fundamental change in the underlying regulatory philosophy towards the management of systemic risk. All these changes constituted a significant shift in the underlying regulatory logic, away from a belief in the discipline of the market towards more stringent capital regulations, macro-prudential regulation and a more interventionist attitude. Whilst it has long been the case for regulated organizations that they must balance regulatory demands with the pressures stemming from the market imperative, the variation in banks' responses to regulatory change demonstrated that achieving this balance is made more problematic by the uncertainty associated with the post-crisis regulatory environment.

The regulatory ideal of achieving the full integration of regulatory requirements within the business corporation is only possible with specific types of regulatory techniques and enforcement strategies. As opposed to traditional 'command and control' regulation, techniques such as enforced self-regulation (Braithwaite, 1982; Hutter, 2001), management-based regulation (Coglianese & Lazer, 2003), and meta-regulation, (Gilad, 2010) aim to 'harness the regulatory power of the company and become an integral part of corporate life' (Hutter, 2001, p. 295). Here, the regulator assumes more of a monitoring and oversight role, with the expectation that firms will devise their own compliant risk management systems and processes specific to their particular circumstances. Prudential regulation in the guise of Basel 2, Basel 3 and the respective European Capital Directives, has been cited as an exemplar of this type of regulation (Black, 2012a; Ford, 2010; Power, 2007). Rigorous and effective risk management and commensurate levels of regulatory capital are considered critical to meeting the overarching regulatory objective of the stability and soundness of the global financial system.

As Chapters 4 and 5 illustrated, this regulatory objective can be in tension with the governing logic of the market, where the goal of delivering 'shareholder value' through increased profitability proliferates. Nonetheless, Chapters Five and Six also show the increasing amount of time, people and money that banks were devoting to managing the complexity and uncertainty of regulatory change in the post-crisis environment. In particular, Chapter 5 suggests that there are organizational practices where the logics of the market and regulation can be reconciled, such as in the setting of risk appetite. This chapter aims to explore the interplay of market and regulatory logics to ascertain whether there are broader indications of achieving a balance between the two whereby banks accept that regulatory rules and their associated practices must now become part and parcel of 'business as usual'.

This chapter also seeks to understand the process of regulatory institutionalization more deeply, drawing on both neo-institutional theory and models from regulatory literature. The data from the qualitative interviews is used to develop a series of indicators; empirical factors that indicate the degree of regulatory institutionalization. These include not only the organizational changes necessary for regulatory compliance but also less tangible indicators such as attitudinal and cultural shifts. Then, the endogenous and exogenous conditions which can either inhibit or facilitate the institutionalization of regulation are examined. The implications of these findings for theoretical understanding of the institutionalization process are discussed and, given the complexity and scale of financial regulatory reform since 2008 and the high levels of associated uncertainty, the chapter concludes by examining whether regulatory institutionalization is even possible under such circumstances.

Prudential regulation as management-based regulation

At its core, prudential regulation has an institutionalizing ambition with respect to financial risk management practices within the banking industry. This is typical of meta-regulatory regimes, such as health and safety (Gunningham, 2007; Gunningham & Sinclair, 2009; Hutter, 2001), food safety (Coglianese & Lazer, 2003) and environmental protection (Coglianese & Nash, 2006). Chapter 3 explained that the introduction of Basel 2 was not just intended to increase the sensitivity of risk measurement for the calculation of capital ratios, it also aimed to improve risk management practices throughout the global banking industry. This was not to be achieved through detailed, prescriptive rules, but by banks designing and operating risk management policies, systems and practices in line with broad regulatory expectations. In other words, the objective was for 'good' risk management to be embedded (or institutionalized) in the core operations of banking organizations and for organizations to take responsibility for their own risk management practices.

Evidence of the institutionalizing ambitions of the BCBS can be found in the rules themselves. For example, Basel 2 sets out the minimum requirements for banks wishing to use the advanced calculations for credit risk, including requirements for the design and operation of the rating system, corporate governance and oversight, how internal ratings should be used, how risk should be quantified and the validation process for internal estimates of parameters (BCBS, 2006b, pp. 88-91).

In respect of the banks' internal estimates of risk, the BCBS introduced the principle of the 'Use Test'. Put simply, this required banks to not only use the risk estimates that were produced to calculate their regulatory capital ratios but to also incorporate them into the day-to-day business of the bank, such as 'strategy and planning processes, credit exposure management and reporting' (BCBS, 2006a). The Basel Committee's guidance on the Use Test explains why this is necessary:

> *'The IRB [Internal Ratings Based][87] use test is based on the conception that supervisors can take additional comfort in the IRB components where such components "play an essential role" in how banks measure and manage risk in their businesses. If the IRB components are solely used for regulatory capital purposes, there could be incentives to minimise capital requirements rather than produce accurate measurement of the IRB components and the resultant capital requirement. Moreover, if IRB components were used for regulatory purposes only, banks would have fewer internal incentives to keep them accurate and up-to-date, whereas the employment of IRB components in internal decision-making creates an automatic incentive to ensure sufficient quality and adequate robustness of the systems that produce such data.' (BCBS, 2006a, p. 2)*

The point here is that the institutionalization of the regulations was not only an explicit regulatory objective, but also critical to achieving the overarching regulatory goal of the safety and soundness of the financial system. The global financial crisis revealed the significant flaws in the Basel 2 rules (Financial Services Authority, 2009e; Larosière, 2009; Tarullo, 2008) and, it has been argued, meta-regulation as a technique of regulatory governance (Black, 2012a; Ford, 2010). The Basel Committee responded by immediately introducing changes to the rules for calculating capital for securitization products and market risk (known as Basel 2.5) and then making more fundamental changes in the introduction of Basel 3. To recap, these revisions increased the quantum

[87] Internal Ratings Based is the name for the more advanced modelling approach for calculating credit risk parameters, using the banks' own risk models.

and quality of regulatory capital (including counter-cyclical capital buffers), introduced a leverage ratio and new rules for measuring and monitoring of liquidity risk. What they did not do, however, was fundamentally change the way in which banks were required to calculate capital for credit risk[88] or indeed the operational requirements for risk management practices within banks.

In addition to these rule changes, the BCBS also emphasized the importance of culture to the soundness of bank governance:

> *'A demonstrated corporate culture that supports and provides appropriate norms and incentives for professional and responsible behavior is an essential foundation of good governance' (BCBS, 2010e, p. 16)*

Echoing this international perspective, in 2014 the PRA released a policy statement on how it would use its powers to address cultural failings in financial firms. The PRA explicitly states that it 'does not have a particular "right culture" in mind' but does state what would be indicators of cultural failings including weak risk management controls and practices (Prudential Regulation Authority, 2014e, p. 3). Prudential regulation therefore explicitly acknowledges that not only are the rules themselves important, there must also be an accompanying culture of adequate risk management within banking organizations, which requires not only the letter of the prudential rules to penetrate to the core of the bank, but also the spirit.

Models of institutionalization

This chapter draws on both the wider theoretical understanding of institutionalization found in neo-institutional organizational literature and models of the institutionalization of regulation or compliance systems specifically. Typically, in the former, institutionalization is described as the 'process by which individual actors transmit what is socially defined as real' (Zucker, 1977, p. 728). Whilst the degree to which social knowledge, processes and structures become institutionalized over time can vary, Zucker (1977) contends that the greater the degree of institutionalization

[88] Some changes were introduced to the way that banks calculate counterparty credit risk which is a sub-set of credit risk

(measured in terms of objectivity and exteriority), the lower the dependence on social control for maintenance.

Developing this idea in terms of regulatory logic, it would therefore follow that the more regulation can be institutionalized as a day-to-day, taken for granted aspect of organizational life, the more success the regulator will have in ensuring compliance with that regulation. This understanding is at the heart of management-based regulatory techniques which require organizations to design, build and operate corporate compliance frameworks in line with broadly specified regulatory requirements.

In her work on corporate compliance, Hutter (2001) researched the risk management systems that were implemented to manage health and safety on the British Railways. This in-depth study resulted in the development of a conceptual model of corporate responsiveness to regulation which describes the phases or stages involved in the institutionalization of regulation within an organization. The first stage, 'design and establishment' consists of activities such as participation in regulatory consultations, designing new organizational structures and processes, developing plans for change programmes and training and communication activities relating to new regulations. The second 'operational' stage sees these plans being put into action within the organization, the systems and process changes are made and become part of 'business as usual' and the awareness of, and compliance with, risk management spreads throughout the organization. The final 'normalization' stage is achieved when 'risk management and regulatory compliance are fully integrated parts of the corporate culture' (Hutter, 2001, p. 302). Two characteristics of this model are important to note. Firstly, this model was designed as a heuristic device to better understand the process of regulatory institutionalization, and it is on this basis that the model is used in this study. Secondly, Hutter emphasizes that the model is not unilinear, with an organization moving 'forwards' from one stage to the next (Hutter, 2001, p. 304). Organizations may also move backwards and may even miss a stage as they do so.

A similar three stage model of the 'institutionalization of integrity' in corporations was developed by Parker (2002) and identified initial senior management commitment to compliance as an important first stage. This is then followed by the 'acquisition of specialized skills and knowledge' (Parker, 2002, p. 58) usually (but not always) in the form of dedicated compliance professionals. Finally, regulatory responsibilities are integrated into operating procedures and performance appraisals of those working in the wider organization.

Gilad (2011) uses both these 'professionally-centred' models of regulatory institutionalization to consider the implementation of the FSA's Treating Customers Fairly (TCF)[89] initiative. Gilad found that, in contrast to both Hutter and Parker's models, there was participation not only from compliance professionals but also the wider business in the initial design and management of the TCF programmes in the banks. Where Gilad's study differs from both Hutter and Parker's models is the finding that

> *'whenever regulatory demands require firms to make fundamental changes to their operations – in terms of scope, expenditure, norms, or practices – firms will be driven, once they feel compelled to act, to delegate primary responsibility for the implementation, and possibly also for the design and evaluation of compliance to managers outside compliance and down the organizational hierarchy. This is because compliance officers are likely to lack the resources, power, and legitimized authority to drive such change on their own' (Gilad, 2011, p. 326)*

Hutter's model was used to inform the analysis of prudential regulation in this study because it features much thicker descriptions of the characteristics and activities associated with each of the three stages. However, the idea of senior management commitment, the introduction of specialist compliance professionals and the integration of regulatory requirements into performance appraisals were taken from Parker's work. Finally, Gilad's idea that involving the wider organization could occur in the earlier stages of the institutionalization process was also considered when analyzing and coding the interview data.

Hutter and Gilad's empirical investigations demonstrated that the process of institutionalization is not straightforward in a relatively stable environment. The

[89] Treating Customers Fairly is a regulatory principle designed to improve the way that financial firms in the UK conduct their business with regards to their retail customers. It aims to ensure customers fully understand the features of the products they buy and to minimise the sale of unsuitable products. TCF was introduced by the FSA in 2007 and continues to be a requirement for all firms regulated by the Financial Conduct Authority.

significant levels of change in the regulatory environment of the banks in the UK created a moving target, not only in terms of the regulatory rules but also in the supervisory approach and relationships and thus, the institutionalization of regulatory logic was even more difficult. The situation was made even more complex because during the period of fieldwork, banks were using both the existing Basel 2 rules to calculate their regulatory capital on an ongoing basis as well as making preparations to meet the new Basel 3 requirements.

Thus, at the time this research was conducted, there were two overlapping sets of regulations at different stages in the regulatory lifecycle - the Basel 2 rules with which the banks were (presumably) already compliant and the Basel 3 rules which were still in the process of being designed and implemented. In addition, as regulatory expectations tightened and the processes for risk model approvals became more stringent, banks were increasingly engaged in remediation work to bring them back into compliance with the existing Basel 2 rules, independently of any new work required for Basel 3. This posed a considerable sense-making challenge for the banking organizations in the sample (for details see Chapter 5), as it was not always clear what aspects of the rules were changing, or how they had changed from one draft proposal to another.

The existence of two overlapping sets of regulatory rules at different stages also presented an empirical problem when trying to ascertain the degree to which prudential regulation had become institutionalized within the banking industry for two key reasons. The first was that it became more difficult to identify the distinct stages of institutionalization, even when using a heuristic model. A reasonable expectation would have been that some aspects of the Basel 2 rules would have at least reached the operational stage, perhaps even the normalization stage, whilst at the same time, it would have been fair to assume the Basel 3 rules would have been in the beginning stages of the model. The second challenge was that, even whilst the Basel 2 rules for credit risk might have remained stable, as Chapter 6 showed, the style of supervision and the toughening of regulatory expectations may have required banks to make additional operational changes (such as amending credit risk internal rating models) to comply with these more stringent standards of supervision. Such changes would necessitate a move backwards from the operational (or normalization) stage to the design and establishment (or operational) stages.

It is also worth noting a methodological limitation regarding the data given that it was not possible to collect in depth data from all the organizations in the interview sample. Thus, with the exception of Bank 1, the analysis relies on the accounts of only a few respondents from each organization. Notwithstanding these complexities, however, using the conceptual model of the institutionalization framework has revealed some interesting and important observations which are discussed below.

Indicators of institutionalization

To think of regulation as being institutionalized is to think of it as being a more or less taken-for-granted aspect of organizational life (Greenwood et al., 2008, p. 15). That is, compliance with prudential regulation has become integral to the operational practices, routines, behaviours and even the values and beliefs of the organization. The intention here is not to provide a precise assessment of how far prudential regulation has been institutionalized in the UK banking industry, as this would require a different methodological approach. Rather, the aim is to use the existing heuristic models of regulatory institutionalization discussed above to identify and add to the types of indicators that are associated with each stage of the model to give a sense of the degree of institutionalization.

It can be difficult for organizational members to identify and articulate the various aspects of their organization's operations and culture that result directly from the implementation of regulation precisely because they are so taken-for-granted. Therefore, instead of asking interview participants direct questions about the degree to which they perceived prudential regulation to be institutionalized in their bank, the interviews were analyzed to find types of activities or organizational changes that may be indicative of the process of institutionalization. The coding framework for this analysis was derived from Hutter's model and themes that emerged inductively from the data. Four main categories of indicators were found – Systems and Procedures, Governance and Structures, Integration into Business Practices and Knowledge and Commitment.

Systems and Procedures refers to the operational aspects of the bank that either needed to be created or modified across different parts of the organization in line with regulatory requirements. For example, credit risk models not only required a mathematical methodology to be developed but this then had to be coded into computer software. In addition, control procedures had to be built around the model to ensure data was kept up to date and exceptions or errors were reported and investigated.

The creation of executive steering groups or committees charged with overseeing regulatory related issues or decisions were included in the **Governance and Structures** category. This also comprised the formal organizational hierarchy and functions within this that have explicit responsibility for regulatory matters (see Chapter 5). It should be emphasized here that this category relates to both structures put in place to manage regulatory change and those that were required on an ongoing basis to manage regulation, such as regulatory reporting units.

Indicators relating to the third category, **Integration into Business Practices**, were evident when activities that had been implemented primarily to meet regulatory objectives had been incorporated into regular business routines. Whilst this appears to be synonymous with the notion of institutionalization itself, the latter term incorporates not just the material practices of the organization but also the technologies, structures and less tangible aspects of organizational life.

Indeed, the final category, **Knowledge and Commitment**, focused on these less tangible parts of institutions. Knowledge pertained to the levels of regulatory understanding across the organization, particularly in those organizational units that operated at a greater relational distance from the regulator. Also, drawing on Parker's work, the degree of senior management commitment was considered an important factor to identify (Parker, 2002).

For each of these categories, lower level indicators were identified and these were then classified according to the stage of the institutionalization model to which they best corresponded. This framework is shown in full in Appendix 3. Examples of how this coding framework was applied to the interview data are shown in Table 7.1.

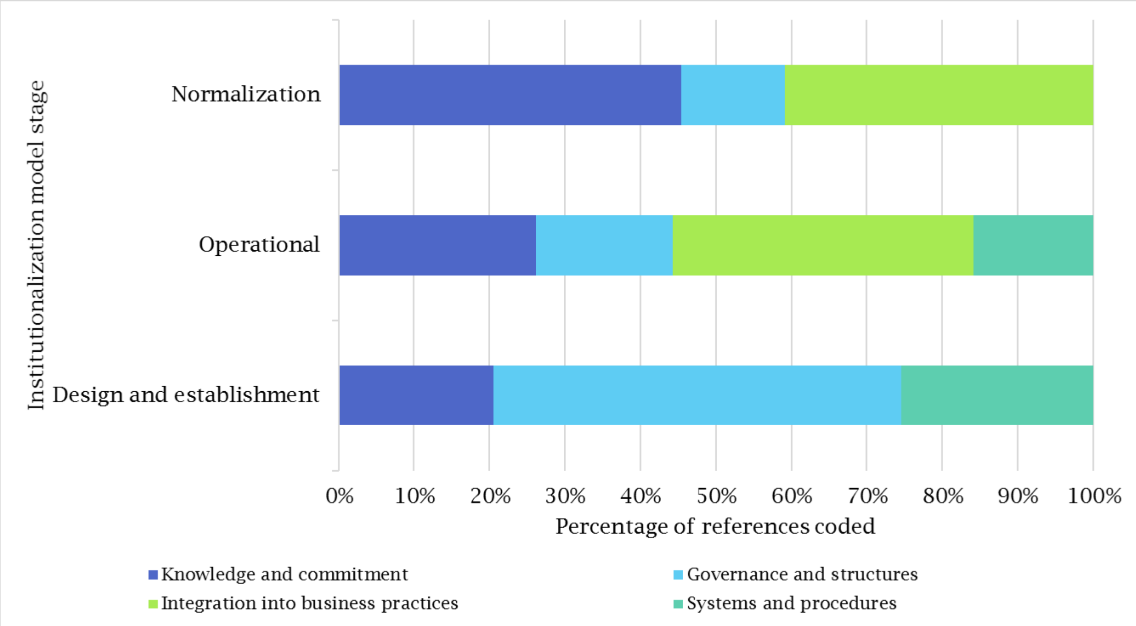
Table 7.1 Examples of coding for institutionalization indicators

Category	Indicator and Example	Stage
Systems and procedures	IT Systems changes *'[Implementing] monitoring and processes and systems development. You know, it's a question of okay we're doing this on a spreadsheet to do the pro forma [capital impact figures] - it's not good enough, we need a more robust process, we need systems in the heart of it, so it's just a range of all of that and getting it in place.' (Participant 20, 2014)*	Design and establishment
Systems and procedures	Regulation driving changes in risk management *'A lot of the agenda at the moment is regulatory driven because…to be honest if the regulators weren't doing things, a lot of these things we'd be self-motivated to do anyway, given the learnings of the crisis and things but the regulators are obviously, you know, coming at the moment with lots of different regulations that are driving action and system investment.' (Participant 8, 2013)*	Operational
Governance and structures	New governance structures to manage regulatory change *'So we have established a fully-fledged structure with a project management office and outside help from one of the big four [consultancies] - we have the steering committee, which includes business heads, control function heads, corporate function heads. And then we have different working groups and task forces' (Participant 13, 2014)*	Design & establishment
Governance and structures	Internal communication of regulatory matters *'We are better at communication than ever within the firm about what we are doing, so actually, we have forums where we talk to every division every month and cascade the regulatory conversations.' (Participant 8, 2013)*	Operational
Governance and structures	Monitoring ongoing compliance *'The pipe tends to go from us [Regulatory Affairs] into Risk, in terms of risk implementation. And normally it's their job to liaise with Compliance. Broadly most things are compliant, so we try and understand it, try to change it, and then someone starts implementing it before we've finished changing it and at some point the implementation is done, and the deadline's met, ideally, and post-implementation compliance [is achieved].' (Participant 22, 2014)*	Normalization

Category	Indicator and Example	Stage
Integration into business practices	More efficient use of capital *'One of the things probably overarching this is in terms of the changes that are hitting the wider organisation because of the magnitude of them it's driven a different capital management strategy and that has cascaded down from the Group to the Divisions and the Divisions are now having to think about how to do business differently and taking, in some cases, quite severe action because businesses are no longer going concerns in light of the amount of capital they are using.' (Participant 5, 2013)*	Operational
Integration into business practices	Regulation as part of regular business routines *'it's very much around looking at the same portfolio but in a number of different ways you know. Utilising a number of different stress tests, utilising more kind of market risk metrics just to get a better appreciation of what is going on there which is the right thing to be doing. And you can say that is purely risk-based because there is no capital impact from that whatsoever' (Participant 9, 2013)*	Normalization
Integration into business practices	Regulation impacts business strategy *'There has been also a cultural shift which is now acknowledging, hey, this [regulation] is now part of our life, we should just deal with it, and work with it and actually look at it. You can't talk about business strategy any more without knowing about regulation.' (Participant 13, 2014)*	Normalization
Knowledge and commitment	Explaining changing regulatory environment to wider organisation *'So it's helping [to] convey those messages and when we do get hit you go back to the business and say 'look guys, the world has changed. We got smacked because of 2008 and we haven't gotten over that yet. The world has changed.' (Participant 3, 2013)*	Design & establishment
Knowledge and commitment	More time devoted to regulatory matters *'We spend a lot more money on regulation, so more people, better quality people, more senior people, bigger budgets, more time internally spent on how to respond constructively to the PRA's demands. That's probably the biggest change. A lot of time spent considering how to react and respond to regulatory prudential initiatives.' (Participant 20, 2014)*	Operational
Knowledge and commitment	Changes to bank regulatory culture: *'With the regulation from Basel 2.5 CRD3 coming in, and CRD4 as it starts to get very close to coming in has driven a complete mind-set change in the business over how it manages its capital and the focus it needs to put on it which is a good thing.' (Participant 5, 2013)*	Normalization

As these examples illustrate, the data analysis revealed that it did not necessarily follow that indicators for each category were present in each of the three stages of the institutionalization model. Figure 7.1 shows how the indicators identified in the interview data were distributed over the three stage of the institutionalization model.

Figure 7.1 Distribution of indicators across the institutionalization model

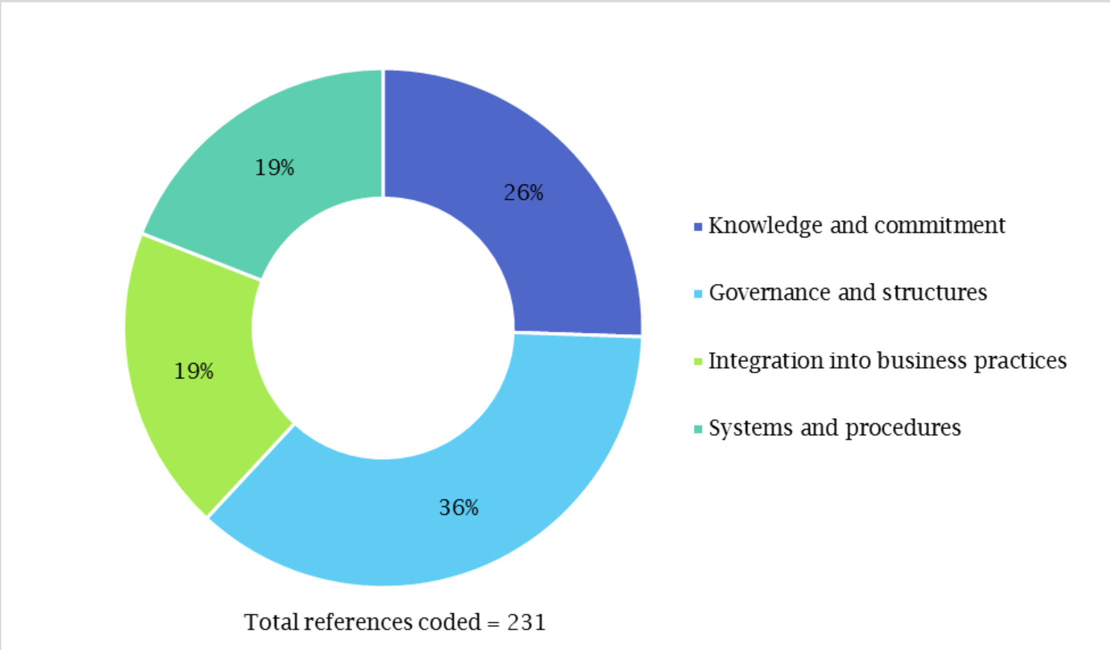


Source: Interview data

Whilst the categories 'Governance and Structures' and 'Knowledge and Commitment' had indicators that represented all three stages of the model, for the 'Systems and Procedures' category of indicators, examples were only found for the first two stages. Similarly, indicators of 'Integration into Business Practices' were only found for the second and third stages. This can possibly be explained by the fact that systems and processes were in a continual state of flux, requiring constant adaptations in response to new regulations or issues that had been raised by the regulator with regards to compliance with existing regulations. Alternatively, if the necessary system and process changes have been completed and become part of business-as-usual, the lack of ongoing changes might be more indicative that the normalization state had been reached. Similarly, full integration of regulatory changes into business practices is unlikely to occur in the first stage of the model, as these practices are themselves being specified as part of design and establishment.

A key finding is that the frequency of references to new or changing governance or organizational structures as a direct result of regulation was almost double those of any other categories of institutionalization indicator, as shown in Figure 7.2. Nearly half these references were coded to just three indicators - new governance structures to manage regulation, regulatory change programmes and new teams created to manage regulatory relationships.

Figure 7.2 Proportion of references to categories of indicator



Source: Interview data

In terms of managing regulation, as Chapter 5 showed, some of the new governance structures were created to manage all types of regulatory requirements (prudential, conduct and structural changes such as recovery and resolution planning) and some were specific to prudential regulation. These indicators are all associated with the design and establishment stage of the model.

Chapter 5 argued that these governance and structural changes were typical of the re-organization activities that occur after significant risks crystallize into a crisis. However, institutionalist theory also contends that the creation of new organizational structures can be associated with a process of decoupling, whereby formal structures are implemented but act as a 'buffer' to allow the technical core of their operations to remain unchanged (Meyer & Rowan, 1977, p. 357). Such formal structures can be adopted ceremonially in the name of legitimacy and ultimately, organizational survival. Relating this idea specifically to law, Edelman et al. (1991) suggest that 'an organization can point to structural change as evidence of its compliance, without necessarily creating significant change in behavior' (Edelman et al., 1991, p. 75). Parker also cautions against this 'symbolic' rather than substantive degree of institutionalization, suggesting that is it one of the pathologies of meta-regulation, often demonstrated by a 'tick-box' approach to compliance (Parker, 2002, p. 142). Edelman goes on to argue that 'it is not always the case that structural elaboration is merely symbolic; structural change may be a means of achieving real improvement' (Edelman, 1992, p. 1543). Nonetheless, using this category of indicators as the only means of measuring institutionalization should be approached with caution.

Indeed, those indicators that demonstrate the integration of regulation into the core business practices of the organization are more likely to be evidence of substantive behaviour changes. The most prevalent indicator within this category was the provision of regulatory advice

> *'to the [Wholesale] Divisions on all aspects of prudential capital policy rules. Effectively how to apply them in relation to particular transactions so transaction review, transaction sign-off, new products approval processes' (Participant 7, 2013).*

In the case of prudential regulation (see above) the principle of the 'use test' is an explicit recognition that the success of Basel 2 depends on the embedding of the risk parameters in the day-to-day business of the banks. Achieving this level of integration is indicative of reaching the normalization stage of the model, penetrating the day to day business decision making processes, illustrated by this interviewee:

> *'We look at the same portfolio but in a number of different ways you know. Utilising a number of different stress tests[90], utilising more kind of market risk metrics just to get a better appreciation of what is going on there which is the right thing to be doing' (Participant 9, 2013).*

[90] Stress tests are a type of scenario analysis whereby the bank analyses its current risk exposures to see what would happen if market conditions worsen, for example if there was an interest rate risk rise or an economic downturn. Prudential regulations require that banks subject their internally modelled risk parameters to a rigorous programme of stress testing that informs senior management decision making. (BCBS, 2009)

The other indicator that was associated with the normalization stage of the model was when regulatory considerations impact the business strategy of the bank.

> *'It's driven a different capital management strategy and that has cascaded down in terms of from the Group to the Divisions and the Divisions are now having to think about how to do business differently and taking, in some cases, quite severe action because businesses are no longer going concerns in light of the amount of capital they are using' (Participant 5, 2013).*

Indeed, the introduction of higher capital requirements and new liquidity requirements as part of Basel 3 / CRD 4 have had significant effects on banks' business models. A recent survey found that

> *'Eighty-one percent of respondents said they are evaluating portfolios, and 44% said they are exiting lines of business, up from 29% last year [2014]. This is being driven by pressure to mitigate falls in return on equity following the capital increases' (Ernst & Young, 2015, p. 3).*

Whilst this was not an explicitly stated objective of these new regulations, banks are deleveraging and/or exiting those business areas or products that are capital intensive or expensive to fund. These business model changes go to the very core of the organization, but it is important to recognize that the motivating logic beneath these decisions is more likely to be that of market and profitability considerations (as illustrated in the quote above) rather than a desire to fully embed regulatory logic and divest more risky businesses in the public interest.

The two indicators that featured most frequently in relation to Knowledge and Commitment were the improved levels of regulatory knowledge in the wider organization and an increased senior management focus on regulation, according to the interview respondents. Increased knowledge about the prudential regulations manifested itself in both the Front Office and Credit Risk Officers[91] actively seeking out information about regulation and also displaying a greater depth of understanding of how the rules relate to their roles:

[91] Credit Risk Officers are those who are responsible for assessing the creditworthiness of a counterparty, using a combination of the outputs from risk models, financial data and judgement based on the past relationship with that counterparty. They are also responsible for ensuring that lending to such counterparties is within the prescribed credit risk management limits.

'I had an interesting conversation with a credit officer yesterday and if you wound the clock back a year ago, he wouldn't have been able to have the same conversation because he wouldn't have had the in depth knowledge that he has [now]' (Participant 9, 2013).

Since the financial crisis, the interview respondents explained that levels of senior management focus and attention on regulatory matters had increased significantly:

'There are very very few people certainly at the senior and upper management level in this bank that do not spend a lot of time with regulators. So I think the whole regulatory agenda has come straight on to the board's agenda. So at every board meeting, every month, the board spend a lot of time on regulatory matters' (Participant 12, 2014).

This corresponds with both Hutter's findings and Parker's contention that senior management commitment is vital to the beginning of the institutionalization process (Hutter, 2001; Parker, 2002). This indicator was therefore coded to the Design & Establishment stage but arguably, this commitment must be sustained throughout the institutionalization process to ensure the requisite funding is made available and to instill the necessary cultural shift that is required to achieve the final stage. Indeed, much of the literature which addresses cultural improvements in the banking sector focuses on the 'tone at the top' and how this then cascades down into the rest of the organization (Financial Stability Board, 2014, pp. 5-7). Increased senior management commitment and knowledge about regulation may also have been connected to the increasing regulatory requirements for individual accountability for regulation. In 2014, the PRA and FCA released a joint consultation paper on strengthening individual accountability within the banking sector, with a focus on Senior Managers and the strengthening of their regulatory responsibilities under the new Senior Manager's Regime (SMR) (Prudential Regulation Authority, 2014d).

The final set of indicators included those related to changes to Systems and Procedures as a direct result of regulatory changes. The complexity of the prudential calculation requirements, the technologically advanced risk models and the data intensive regulatory reporting requirements required sophisticated information technology systems, especially given the volumes of transactional data held by the banks. Changes to these systems took time and resources:

> *'We've got a number of programmes specifically aimed at making it easier to get [risk and regulatory] information out. We're putting in a whole load of systems but they take time and they don't always work straight away' (Participant 6, 2013).*

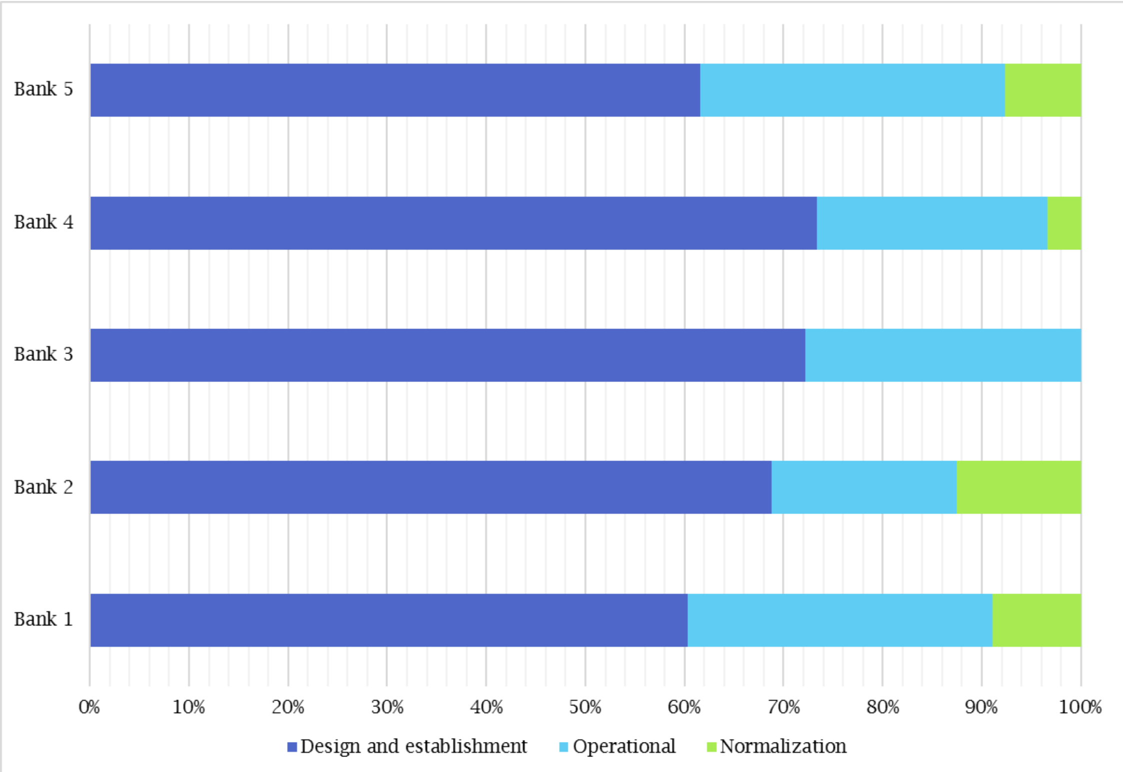
It is not surprising then that the majority of the discussion about Systems and Procedures indicators focused on the seemingly continual updating of computer systems, not only to comply with the new Basel 3 rules but also to meet the tougher expectations for the Basel 2 models. Interestingly, a third of the respondents welcomed the fact that regulation was driving these system changes because:

> *'if we as an institution were smart enough and did sit down and specify exactly what we wanted to do…..it would track what the regulation was trying to put in' (Participant 4, 2013).*

There appears to be some alignment between the organizational ambitions to improve risk management systems and processes and those changes that were required by the regulatory rules or to meet the supervisors' expectations. Indeed, there was some evidence in the interviews that regulatory requirements acted as a catalyst to make changes because the associated investment was deemed to be mandatory. This is explored further in the next section.

Considering these indicators together across all the banks in the interview sample reveals where these organizations are in the process of the institutionalization of prudential regulation. Figure 7.3 shows, for each bank in the interview sample, the proportion of references coded to each stage of the regulatory institutionalization model. This chart is presented along with four strong caveats. First, the size of the sample means that it should not be regarded as a representative picture of the UK banking industry or indeed of each banking organization. Second, it is not necessarily a statistically accurate picture for each bank, given the variation in the number of interviews completed per bank. Third, the interviewees occupy organizational positions which require them to interact closely with regulation on a daily basis and thus their perceptions of the indicators of institutionalization may differ to those of organizational members who are less closely impacted by regulation. Fourth, there may well have been a tendency for respondents to overestimate the progress their respective organizations had made towards the institutionalization of regulation, given that a high proportion of the interviewees occupied organizational positions where they had direct responsibility for aspects of regulatory change.

Figure 7.3 Institutionalization stage by bank



What the chart does show, however, is an indicative view, at a particular point in time of where certain personnel considered their organizations to be in terms of the institutionalization of regulation. It is very clear that the level of normalization of regulation across these five banks is very low, and that these organizations are primarily at the Design & Establishment stage of institutionalization, with nearly two thirds of all interview references coded to this stage. Hutter (2001) suggests that

> *'phase 3 may in reality be a rarity, even an impossibility. Even if it is attained it is likely to be only temporary, as one of the major problems encountered in managing risks is maintaining full compliance once it has been achieved and maintaining regulatory objectives as a priority within the company' (Hutter, 2001, p. 303).*

With this in mind, the next section explores the conditions that can both facilitate and inhibit banks from moving up the stages of the model.

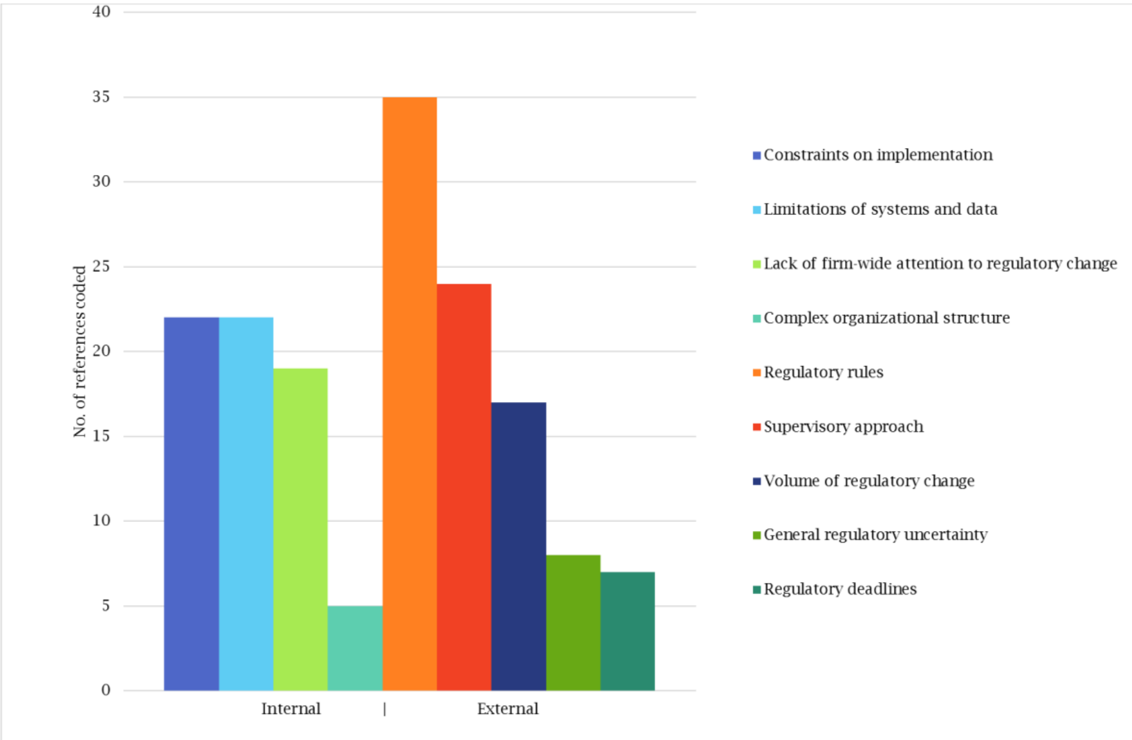
Inhibitors and facilitators of institutionalization

Inhibitors

When analyzing the interview data, it was clear that there were several factors or conditions which inhibited the process of regulatory institutionalization. By an inhibitor is meant a factor or condition that prevents an organization from moving to the next stage of the model, prolongs the time spent at a particular stage or causes the organization to revert to a previous stage.

Inhibitors were classified in terms of their source – whether they originated from within the organizations or from the external regulatory environment as Figure 7.4 illustrates.

Figure 7.4 Internal and external inhibitors to institutionalization



Starting with the internal inhibitors, the two factors which featured most frequently in discussion with the respondents were organizational limitations or constraints on regulatory implementation and the shortcomings of the IT systems and risk and regulatory data structures. Whilst the financial cost of making regulatory changes was often cited as a constraint, the ability to attract the right skills and expertise to interpret and understand the requirements was perhaps of greater concern to the respondents:

> *'I think it's to do with the fact that we don't have, you know, within every bank and every regulatory body we don't have an army of ... em, astrophysics graduates from Oxford with first-class degrees, who can actually get their head round all this stuff' (Participant 20, 2014)*

The scarcity of skilled regulatory staff within both banks and regulatory authorities during the fieldwork period (2013 – 2014) was also more widely acknowledged across the financial industry (Deloitte, 2014; Enver, 2014; Oakley, Kortekaas, & Schäfer, 2013).

In addition, as discussed in Chapter 3, the post-crisis context was a period of significant regulatory change, engendering commensurate changes to occur within banks. At the same time, banks were dealing with the fall out of the crisis in terms of reducing the size of their balance sheets, managing the toxic assets on their books and winding down non-performing parts of their businesses. Such significant changes to an industry and its regulatory regime echo that of Hutter's observation that the privatization of the British Railways and the corresponding restructuring of the regulatory regime resulted in the 'railway industry reverting to the first stage of the model' (Hutter, 2001). Such significant shifts in a firm's non-regulatory environment will also have a bearing on its ability to institutionalize regulation.

According to the interview participants, skill shortages and the volume of changes manifested as change fatigue. As one respondent articulated it, he was 'tired of being tired of change' (Participant 7, 2013). Such 'regulatory jetlag and exhaustion' (Participant 3, 2013) might put a strain on those responsible for implementing regulation, potentially resulting in mistakes and also encouraging a 'tick box' approach to simply getting the work done, the antithesis of institutionalization. Indeed, industry reports highlighted 'change fatigue' as a key concern for banks, claiming regulatory change was absorbing all the 'change capacity' so there was very little focus on business improvement and development (Oliver Wyman, 2014; Thomson Reuters, 2012).

The limitations of information technology systems and the data required for regulatory and risk reporting were also identified as significant inhibitors to institutionalization.

As the quote below describes, this is often due to the age and fragmentation of the computer systems and associated data[92] in question:

> *'It's actually getting that [regulatory] information [that is difficult]. Partly that's legacy systems, if you think of how old some of our systems are and we've built things on top of them to get something so it's actually getting that level of granularity that can be the problem. And then some of the information they [the regulators] want will have to come off the risk system which is fine. All the systems do tie up but not necessarily the way that is intuitive….so I've got a line in the accounts. To get the detail I want I've got to go to the risk systems but the risk systems and accounts are not fully aligned in the way that I need them to be in order to do that exercise' (Participant 6, 2013).*

Problems with IT infrastructure in the financial industry were highlighted when major retail banks experienced significant systems failures which affected their customers in 2014 (Flinders, 2014; Osborne, 2014). Such failures were largely attributed to chronic underinvestment and complex and fragmented legacy systems. These factors have consequences other than system failures as illustrated in the Transparency Report issued by UBS to its shareholders. This report identified fragmented risk data as a contributing factor to the substantial losses it incurred (UBS, 2010). The BCBS also concluded that:

> *'One of the most significant lessons learned from the global financial crisis that began in 2007 was that banks' information technology (IT) and data architectures were inadequate to support the broad management of financial risks' (BCBS, 2013d, p. 1).*

In an attempt to improve the risk data structures in banks, the BCBS issued 'Principles for effective risk data aggregation and reporting' with which those banks designated as Global Systemically Important Banks have to comply by 2016 (BCBS, 2013d). Thus, the regulators have themselves acknowledged the problems associated with the decentralization of risk data as a barrier to effective risk management and the ability to fully embed prudential regulation in the organization.

IT system limitations may well be a symptom of the other major internal inhibitor to the institutionalization, the lack of attention paid to regulatory change by the wider banking organization. There is often a tension between those who are responsible for regulatory

[92] It is estimated that for regulatory reporting purposes, banks in Europe will need to complete sixty separate forms comprising 30-50,000 data items (Haldane, 2012, p. 12) which must be populated or aggregated from hundreds of thousands of data attributes in banks' source systems.

change and the rest of the business (Parker, 2002; Power, 2005b; Weait, 1993), who ultimately not only approve the required budgets but must provide the technical expertise required to understand the detail of the regulation:

> *'SL: So I guess you are sat in between the regulators and the business in the way and it can't always be the most comfortable place to be?*
>
> *P10: Yes, I mean we're often seen as the bearer of bad news. Because you try to obviously articulate things and say what the regulators are proposing saying and I mean clearly for a lot of people, it's, they've had to shift and accept the new realities' (Participant 10, 2014).*

One strategy organizations may use to overcome this as identified by Gilad (2011) is to involve the relevant business people in the Design & Establishment phase of the institutionalization process. Interviewees described how they would attempt to identify appropriate business owners and include them in the governance structures and communication processes about regulatory change (see Chapter 5).

However, this strategy was not always successful, given that there was often a significant time lag between when the standards setters released the first consultation paper and the final legislative rules[93]. Then, it was a matter of finding the regulatory impacts that were most likely to focus organizational minds, which usually tended to be financial:

> *'Banks are probably better at things that have fundamental economic impact in an obvious way, so things that change the amount of capital you have to hold, I think everyone gets that now, people to start to adjust their business model in advance, but I think some of these other things where the financial impact is less obvious, erm, they don't. They see it as a kind of compliance thing and they leave it to the last minute and they struggle every time' (Participant 8, 2013).*

The final internal barrier to institutionalization was the complexity of the banks' organizational structures in combination with the regulatory requirements that cut across these organizational dividing lines. As Chapter 5 demonstrated, many different parts of a bank were involved in both the management of regulatory change and ensuring ongoing compliance with regulatory requirements such as scheduled reporting. In terms of managing change, this respondent described the difficulties involved:

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[93] For the European CRD 4 / CRR legislation, the first consultation paper was released on 26th February 2009 and the final rules appeared nearly four years later on 17th July 2013.

'We need to find a smarter way of doing this because otherwise we're really going to struggle to deliver this because (a) each and every cross-cutting issue needs to be mobilised many times over in each and every division (b) even once you get the divisional efforts mobilised, there's no framework for actually co-ordinating them and that's inefficient and leads to a whole host of issues' (Participant 10, 2014)

The need for the central co-ordination of regulatory change during the design and establishment phase was recognized by several respondents. However, as systems and processes become operationalized within separate organizational silos, there is the risk that the fragmentation of practices and understandings of risk and regulation will reoccur, engendering the 'silo effect' (Tett, 2015) and preventing the move to the final stage of the institutionalization model (Hutter, 2001).

Turning now to the external factors that inhibit regulatory institutionalization, top of the list was the regulatory rules themselves in terms of both how they were changing and how they were designed. The uncertainty of the regulatory rules emerged as the most prominent theme, with respondents remarking that the fluctuation in the rules throughout the legislative process prevented the banks from reaching a stable design and plan for implementation until very close to the final deadline. Similarly, due to the nature of the legislative process in the EU, detailed technical standards were being produced after the main legislative text was in force, which could possibly have changed the established meaning of the rules. In such instances, organizations had to revisit the changes they had already made in light of this new information, requiring them to remain in the Design & Establishment stage for longer.

The complexity of the regulatory rules and the inconsistencies between them also tended to prolong the first stage of the institutionalization model. Complex rules required more time to unpick, to interpret, and to explain to others in the business who also need to understand them:

'Complexity is absolutely okay when it comes to the detailed implementation of something which requires maths to understand it but at the overall level, you shouldn't have to do it you shouldn't have to have that level of if this then that explanation to get the very top level' (Participant 2, 2013).

Even once implemented, embedding the use of the risk parameters calculated by the internal risk models could require a sizeable training programme. In one bank this consisted of a global roadshow that trained over 700 people on the use of a new model. The complexity of the Basel 3 framework has been acknowledged by regulators (BCBS, 2013h; Haldane, 2012) with some suggestions as to how to simplify it, but it is expected these will take some time to develop in consultation with the banking industry[94].

Supervisors have tightened their regulatory expectations, toughened their supervisory style and reduced the provision of detailed guidance to banks since the financial crisis (see Chapter 6). At the time the fieldwork was conducted, the PRA was also relying more on forward-looking judgements rather than mathematical outputs from models (Prudential Regulation Authority, 2014b, p. 5). These factors compounded the uncertainty of the regulatory environment, particularly as judgements regarding compliance were being made *ex post* with little or no supervisory direction given *ex ante.* Thus, even though banking organizations might have believed they had fully operationalized (or even normalized) compliant regulatory or risk management practices, their supervisor could subsequently deem them to be inadequate, requiring a further iteration of design and implementation.

Indeed, several respondents mentioned that their organizations had received approval for Basel 2 risk models prior to the crisis that afterwards, given the tighter regulatory expectations, would not have been approved at all. One of these banks had created a team specifically to improve the risk models that had already been approved but were subsequently judged as inadequate by the PRA:

> *'Yes, our team didn't exist three years ago. My role came into play about five years ago to look at credit risk model compliance against the rules. [The team] didn't exist.' (Participant 3, 2013).*

Where gaps in compliance were identified, appropriate changes were made to these models which were then re-integrated into the risk management operations and

[94] It is also possible that efforts to reduce the complexity of the rules may actually require significant operational changes, moving banks back to a previous stage of the model or keeping them at the Design & Establishment stage for longer.

regulatory reporting of the firm. This resulted in a repeated cycling to and fro between the design and establishment stage and the operational stage of the model.

A lack of clarity or transparency in the supervisory approach was also identified by the respondents as being problematic. For example, supervisors have the powers to require banks to hold additional regulatory capital if they consider those banks to have inadequately assessed their risks[95]. The banks claimed that it was not always clear why they were required to hold additional capital or how the PRA arrived the level they should be holding:

> *'I remember [a senior FSA official] coming to speak to our senior management and our chief executive, finance director - we were having an exchange of views around Pillar 2 and he thought he was giving us deep insights by telling us that they kind of plucked some of the multipliers out of the air' (Participant 15, 2014)*

The banks suggested that if there was a 'lack of science' (Participant 15, 2014) or that the regulator formed a view prior to the review meeting (Participant 17, 2014), this acted as a disincentive to the embedding of risk management processes and capital calculations within the bank as the regulator had predetermined their overall level of capital, irrespective of the banks' own calculations.

Additionally, several interviewees alleged that they thought the supervisor would think of a number for Pillar 2 and then use the various levers (such as the various capital multipliers, floors and add-ons) in the regulatory rules to encourage the bank to reach this target. Whilst this is impossible to verify (Pillar 2 capital discussions between banks and the PRA remain confidential), it is worth noting that the PRA recently announced changes to its approach to assessing capital under Pillar 2 with the explicit intention of providing additional transparency (Prudential Regulation Authority, 2015c).

The final external inhibitor to regulatory institutionalization was the volume of post-crisis regulatory change. The fact that there was a large body of regulatory change in and of itself does not inhibit the institutionalization of regulation, but it will prolong the

[95] These powers are available to the PRA under Pillar 2 of the Basel rules. Supervisors assess both the risks to the firm that should be captured and calculated under Pillar 1 and then also the risks to which banks might become exposed in the future. Banks must also run an annual Internal Capital Adequacy Assessment Process which is an input to the supervisory review. Supervisors may require banks to increase their capital requirements as a result of this review.

process. What became very clear from the research findings, however, was that the uncertainty associated with the changing rules and supervisory approaches caused significant difficulties, particularly when there was a lack of clarity regarding when (and if) the regulatory requirements would stabilize, and therefore how they could be incorporated into the strategic planning of the organization:

> *'When you look at the amount of regulation which is still to come, and you compare it with what has been put in place since the financial crisis, there's actually more to come than we've already had….but when you look at what the consequence of that is, it's a huge challenge because it's very difficult to plan in the face of uncertainty, and all banks are required to plan, and plan years ahead' (Participant 18, 2014).*

If regulations continue to evolve and change, banking organizations will continually move back and forth between the Design and Establishment stage, and the Operationalization stage of the model as they build, test and then implement the requisite operational modifications.

Facilitators

Despite the inhibiting factors discussed above, the interview data did reveal some recurring themes that suggest features of prudential regulation that may help rather than hinder the process of regulatory institutionalization.

The first of these was the financial impact of the regulatory requirements. Prudential regulation is explicitly designed to ensure levels of regulatory capital within banks are sufficient to absorb the losses that they may incur. In addition, one of the stated objectives of Basel 3 and CRD 4 was to increase the overall levels of capital across the international banking system. For individual banks, as discussed in Chapter 5, it was critical for them to assess the impact of these rule changes on their own capital positions and to actively manage their capital as it became an increasingly scarce resource. This led to the embedding of regulation in business practices oriented to capital management:

> *'It's now the case that businesses are much more held to account which has driven from top down that interest in what is driving the capital and then from that, has then driven that sort of lower level tactical activity…it's driven things like are we using the most risk sensitive measures…as a large and sophisticated organization,*

we would be expect to be using the most advanced risk measures which generally are rewarded with the most appropriate levels of capital rather than taking very crude simplistic approaches which tend to be not necessarily more punitive but less sensitive to your risk management techniques.' (Participant 5, 2013)

What this quote also reveals is the motivation behind incorporating active capital management in banks' business-as-usual activities. Approaches to calculating regulatory capital which are 'risk sensitive' often lead to lower capital requirements, or 'more appropriate' levels, as the respondent above comments. Understanding in advance how particular trades will impact regulatory capital requirements and using the most sophisticated models to calculate them was therefore not necessarily motivated by a desire for regulatory compliance. Rather, these 'Business Planning and Mitigation' practices were instigated in response to the market imperative, to protect the profitability of the bank and increase the return on equity for the banks' shareholders (see Chapter 5).

In the post-crisis environment, regulators (and market participants) raised concerns about the variability of risk weighted assets (RWAs, the denominator of the regulatory capital ratio) across the banking industry (BCBS, 2013f, 2013g; European Banking Authority, 2013; Le Lesle & Avramova, 2012). Whilst a significant amount of this variability could be attributed to difference in 'business models, accounting standards or the implementation of international regulatory requirements' (Bank of England, 2011b, p. 38), there was a residual level of variation that could not be accounted for by these factors. According to the Bank of England, 'evidence from the recent crisis suggests that the observed variation in RWAs might not entirely reflect genuine differences in risk-taking' (Bank of England, 2011b, p. 39). The use of advanced internal risk models 'strengthens banks' incentives to adjust their RWA calculations — not because their assessment of risk has changed, but as a way of minimizing regulatory capital charges' (Bank of England, 2011b, p. 39).

The point here is that whilst it is likely that elements of regulation that have a financial or economic impact on firms can facilitate institutionalization, this appears to be driven by the need to conform with market rather than regulatory logic. Banking organizations may well have implemented practices and routines that appear to meet regulatory objectives, such as the accurate measurement of risk and therefore regulatory capital. If the motivation behind such activities is that of minimizing regulatory capital, rather than determining appropriate levels, regulatory and market goals will be in tension, resulting in what Parker describes as a 'pathology' of institutionalization where compliance and business goals conflict (Parker, 2002, pp. 145-149). Organizational members occupying roles embodying regulatory logic (see Chapter 5) and working to achieve the institutionalization of that logic may well be concerned that whilst the outcomes of these practices are compliant, there will not be the corresponding change in the behaviours and values associated with them. This matters because these are the same actors that liaise with the PRA and will have to demonstrate that the bank has 'a culture that supports its prudent management' (Prudential Regulation Authority, 2014e, p. 3). Alternatively, organizational members inhabiting roles responsible for the financial success of the firm might argue that as long as banks are performing capital calculations correctly and in compliance with the regulations, there is no conflict, despite the goal to minimise capital. This position, however, will be harder to defend to the the PRA, given the increased regulatory focus not just on mechanical calculation rules and models but also on matters of governance and culture (Financial Stability Board, 2014).

The second facilitating factor also featured financial considerations. In a severely cost-constrained post-crisis environment, the pot of money within banks for discretionary internal investment decreased, and was likely only to be spent on those changes that were deemed mandatory. Investment to achieve regulatory compliance usually fell into this category, and, as this respondent discusses, what was considered mandatory was broader then just meeting the minimum requirements:

> *'The understanding of the regulation and their requirements and the technical nature of it is actually going up a lot more than it used to. I think, and once again I could be wrong on that, but I think, and getting broader' (Participant 3, 2013).*

Additionally, another interviewee felt that the pressure from regulators was helpful to improve internal risk management

'My concern would be that if the pressure comes off too much, then the internal pressure on our ability to take budget and improve things will decline and that would be our worry. I would hate to see us get to the point where we kind of flop over the line for CRD 4 and all of the other good stuff that should follow, maybe some of the controls or additional processes that we could do to make it smarter, or we've gone half way to developing something and yet for just a little bit more money, just a little more budget would improve it so dramatically, basically beyond the expectations of the regulator' (Participant 4, 2013).

This is a clear example of how the tougher stance adopted by the PRA manifests within the regulated organization. Regulatory (and risk) professionals within banks understood that the regulator had more power than in the previous era of 'light touch' regulation (see Chapter 6) and leveraged this power internally to argue for a significant share of the budget. This money was also then used to integrate regulatory practices into internal risk management and further the institutionalization process.

Investment funding to support regulatory changes to risk management processes is closely linked to the final facilitating factor, which is the alignment of external regulatory and internal risk management objectives. When questioned, several respondents asserted that the changes that were being made to implement the new prudential rules were changes that they would ideally be making to improve their internal risk management processes anyway.

'A lot of the change is smart, it's stuff that frankly we should have been doing and we should have been pushing ourselves as an institution to do….Although the project I've been working on has a finance / capital implications, really, truly I'm only focused on the internal credit risk methodologies and improving our processes from an internal credit risk standpoint' (Participant 4, 2013).

This respondent made the point that the data that was required for the internal risk models was data that was useful for other purposes:

'SL *Would those changes be the same if you were doing it purely for risk management or would you be doing it in a different way?*

P3 *There are some definite benefits that the business has got from [the regulator] forcing that we need this information for the models so you must capture that and therefore you will understand a lot more about your portfolio as a result' (Participant 3, 2013).*

The earlier discussion of the indicators of institutionalization also emphasized the convergence of regulatory and internal aspirations for improvements to risk management practices. As Chapter 5 showed, risk management functions have become increasingly involved in working to manage prudential regulatory change and implementation. A recent survey showed that Chief Risk Officers in financial institutions are increasing their focus on regulatory compliance and expanding the size of their teams to do so (Ernst & Young, 2015). This increased involvement of risk management in regulation is indicative of regulatory logic pervading these organizational roles to a larger degree than before the financial crisis, giving risk managers more organizational power and control.

Gaining additional benefits from implementing regulation over and above regulatory compliance is an important facilitator of regulatory institutionalization. Chapter 5 discussed how regulatory professionals would use of the symbols and practices of market logic to obtain wider organizational support for the management of regulatory change. In a similar manner, by emphasizing the financial incentives of regulatory compliance such as cost reduction, increased revenue and operational efficiency, firms were attempting to derive 'additional value' from regulatory compliance by meeting internal business goals as well as external regulatory goals from the same operational change. Here, then, there is another opportunity for firms to reconcile the conflicts between regulatory and market logic by finding strategic ways to profit from regulatory change. Plenty of assistance is available from external management consultants who can advise their clients on gaining competitive advantage from regulatory compliance (KPMG, 2014; PriceWaterhouseCoopers, 2015).

Additionally, the interviewees mentioned that practices such as stress testing and better data aggregation were critical to effective risk management and that because they were regulatory requirements, it was easier to get organizational support (and funding) for making the necessary changes. Institutionalization, then, is more likely to occur if regulatory requirements are aligned with the goals of particular organizational members within certain functions. As Chapter 5 demonstrated, however, large banks have fragmented organizational structures and levels of regulatory engagement vary widely with occupational roles. To achieve regulatory institutionalization, the challenge is for those organizational members in roles that embody regulatory logic to obtain co-operation and commitment from the wider organization and to do so, they must possess the status, power and requisite skills (Fligstein, 1997) within the wider organization in the first place to ensure they can obtain co-operation and commitment. Indeed, this is in line with Tolbert and Zucker (1999) who contend that the 'full institutionalization of a structure is likely to depend on the conjoint effects of relatively low resistance by opposing groups, continued cultural support and promotion by advocacy groups and positive correlation to desired outcomes' (Tolbert & Zucker, 1999, p. 184).

Discussion

The analysis of the institutionalization of prudential regulation in UK banks in the period following the financial crisis paints a picture of an industry that is firmly in the design and establishment stage of the institutionalization process. Whilst this is somewhat understandable given that Basel 3 regulations had been finalized only shortly before the fieldwork began, the majority of the Basel 2 rules pertaining to credit risk and the accompanying operational processes had been in place for several years. As this chapter has demonstrated, the banks cited several internal and external factors that can prevent or inhibit them from achieving the full integration of the prudential rules into their business-as-usual practices. Internal inhibiting factors included constraints on implementation, the limitations of systems and data, lack of firm wide attention to regulatory change and the complexities of the organizational structure. External factors that were likely to inhibit institutionalization were the regulatory rules themselves, the supervisory approach, the volume of regulatory change, the regulatory deadlines and regulatory uncertainty. The three facilitating factors were the financial impact of the new rules, the mandatory nature of regulatory changes attracting funding and in some cases the regulatory requirements aligned with the banks' risk management aspirations. Taken together, these findings point towards four key insights – a deeper understanding of the process of regulatory institutionalization, the complexity of regulatory implementation, the interplay between regulatory and market logics that is revealed during the implementation process and finally, the question of whether institutionalization is even feasible in the post-crisis regulatory environment.

By building on the conceptual models developed by Hutter and Parker, and tested empirically by Gilad, (Gilad, 2011; Hutter, 2001; Parker, 2002), this study identified four categories of factors that indicate institutionalization – systems and procedures, governance and structures, integration into business practices, and knowledge and commitment. However, not all of these indicators should be given equal weight when trying to ascertain the degree of normalization of regulation. Neo-institutional theory allows for the possibility of the ceremonial compliance, associated with the creation of structures specifically designed to appear compliant but which protect the rest of the organization from having to implement substantive change (Bromley & Powell, 2012; Meyer & Rowan, 1977; Pache & Santos, 2010, 2012). Thus, examining changes to governance and structures alone may not give a true picture of the degree of institutionalization. As Hutter (2001) suggests, there are other factors that must be considered such as integration into business processes and increased levels of knowledge and commitment. However, these factors, which are indicative of the final stage of the model are also the hardest to identify, as they are cultural and cognitive.

The investigation of the factors that both help and hinder regulatory institutionalization has highlighted some of the complexities associated with the implementation of prudential regulation within banks. Even assuming that banks are behaving as 'good corporate citizens' (which may not necessarily be the case) and intend to achieve full and integrated regulatory compliance, there may still be significant obstacles along the way. Firstly, organizational attention to regulatory implementation will vary, with certain organizational constituencies unwilling to become involved due to other conflicting priorities. These conflicts can also affect how resources are allocated to regulatory change, though the data showed that in general, regulatory implementation was considered mandatory so this was less of a problem than it had been before the crisis. Even when organizational attention is focused on implementation, the complex structures of large, internationally active banks combined with the fragmented (and often out of date) infrastructure and technical complexity of the rules makes the task incredibly challenging. Nevertheless, there are signs that banks are attempting to meet some of these challenges, particularly by ensuring there is greater senior management focus on and commitment to regulatory implementation and that there is sufficient funding available to make the necessary changes.

In terms of senior management commitment to regulation, Chapter 5 illustrated that the organizational status of the Head of Regulatory Affairs (or similar functions) has been elevated since the financial crisis, with the hiring of senior ex-regulators (Masters, 2011, 2012; Treanor, 2013) and increased Board time devoted to regulatory issues. It was not possible to determine from the fieldwork data whether this increased executive focus on regulation was substantive or ceremonial or whether it was driven from within the organization as opposed to being imposed by external regulatory changes such as the Senior Managers Regime. Despite the cause, perhaps what is happening here is a shift in power away from those in the revenue making parts of the business to those that sit in the control functions. Whilst this is clearly desirable from a risk and regulatory perspective, this chapter also demonstrated that conformity with market logic drives the factors that are most likely to facilitate the institutionalization of regulation. It is not clear whether this is deliberate on behalf of the standard setters – to appeal to the theories and narratives of market logic to encourage the integration of the prudential rules[96] or whether in fact, there is a closer alignment between regulatory and market logics than the post-crisis political and regulatory rhetoric would suggest.

Notwithstanding the previous point, what this chapter clearly demonstrates is that prudential regulation, in the form of Basel 3/CRD 4, is unlikely to become normalized in the UK banks until the rules themselves are stabilized and the level of domestic, European and international regulatory change reduces. Uncertainty is the biggest

[96] This is not to imply that the regulators and standard setters have been 'captured' by the banking industry, rather that by framing regulatory requirements using market logic, compliance is more likely to be achieved.

inhibitor to regulatory institutionalization, irrespective of whether it is uncertainty about regulatory rules or a change in the supervisory approach.

Postscript

In a recent speech, Andrew Bailey from the PRA stated that

> *'There is [still] work in Basel but that is much more about refining the framework than a step change in capital requirements. As part of this there is work to agree and implement the leverage ratio internationally, and to improve the use of models to estimate capital requirements so that they are used only for asset classes that lend themselves to modelling of this sort' (Bailey, 2015).*

However, according to the work that was still ongoing by the Basel Committee (see Table 7.2), the rules had not been stabilized (BCBS, 2014d). These policy measures were also likely to require operational impact analyses, quantitative impact analyses and then appropriate modifications to systems and procedures, signifying a move back to the design and establishment stage of the institutionalization model. There is, then, a trade-off here, between constantly adjusting regulation to get a 'better design' and enabling regulatees to institutionalize prudential regulation. It is not clear that this trade-off is understood or acknowledged by standard setters and supervisors. In December 2015, the Governor of the Bank of England publicly stated that the remaining BCBS work on capital and liquidity did not amount to Basel 4 and that the industry's concerns about the possible capital impact and implementation costs were exaggerated (Binham, 2015; Groendahl, 2015).

Table 7.2 BCBS remaining work for refining Basel 3 (as at 2014)

Type of Policy Response	Policy Measures	Status	Finalisation
Review of the standardised approaches	Credit risk	Consultation by end-2014	End-2015
	Market risk	Second public consultation completed	End-2015
	Operational risk	Proposed revisions published October 2014	Mid-2015
Capital floors	Replacement of the Basel II transitional floor with a permanent floor based on the Standardised Approaches for	Consultation by end-2014	End-2015

	credit, market and operational risk		
Credit risk internal models	Constraints on credit risk model parameter estimates Alignment of definitions of exposures under IRB and revised Standardised Approaches Guidance to support the risk models framework	Consultation by mid-2015	End-2015
Market risk internal models	Greater standardisation of traded market risk model requirements	Second public consultation completed	End-2015
Leverage ratio	Complementary measure aimed at restricting the build-up of excessive leverage and at mitigating model risk	Exposure definition finalised – monitoring and calibration 2015-17	Disclosure 2015 Implementation 2018
Enhanced disclosure	Improvements to existing disclosures to describe different risk model approaches	Policy released for consultation	End-2014
	Additional disclosure requirements	Policy under development	End-2015
Additional analysis and ongoing monitoring	Analysis of retail and small and medium-sized enterprise credit portfolios Analysis of off-balance sheet lending commitments	Analysis ongoing	End-2015
Framework review	Strategic review of the capital framework against Committee objectives	Review under way	

Source: BCBS (2014d, p. 6)

Furthermore, at the time of writing, there are indications that the tough stance taken by the Government towards the banks after the crisis is softening. The Chancellor of the Exchequer talked of a 'new settlement' with the financial services industry (HM Treasury & Osborne, 2015), the departing Lord Mayor of London stated that 'regulators must seek the support of practitioners. Working together and ending up in the right place: not with light regulation, but the right regulation' (Lord Mayor of London, 2015). There is also speculation that the resignation of Martin Wheatley, the Chief Executive Officer of the Financial Conduct Authority was at the behest of the Chancellor of the Exchequer due to the tough stance Wheatley was considered to take towards the City (Griffiths, 2015; Inman, 2015; Moore, 2015). The recent rhetoric has been interpreted as a new 'rapprochement between the regulator and the City' (Binham, 2015). The political, social and economic context has a substantial influence on how regulation is supervised and enforced (see Chapters 4 and 6). These recent speeches and changes in senior regulatory personnel might well be signaling a swing in the regulatory pendulum back towards less stringent regulation, with the possibility that the tensions between regulatory and market logic are again recalibrated in favour of market logic, regulatory change is regarded as less of a risk and the institutionalization of regulation becomes even less likely.

Chapter 8 - Conclusion

This thesis has explored how banks in the United Kingdom responded to and managed changes to prudential regulation between 2006 and 2014. The sheer volume and scope of changes in the regulatory environment over this period were a direct response to the financial crisis. Aiming to prevent such crises happening again in the future, policy-makers reformed how risk management in the banking industry was regulated by changing not only the rules themselves, but also the way in which banks were supervised. Furthermore, the intellectual foundations of financial regulation had been brought into question by the events of the crisis and alternative theories about how to deal with systemic risk, such as macroprudential regulation (see Chapter 3), were incorporated into the new regulatory regime. This thesis has argued that these shifts created a moment of profound uncertainty for those banking organizations subject to this regime, providing a rich empirical context within which to investigate questions about how organizations respond to and manage regulatory change, how the dynamics of the relationships between the regulated and the regulators are affected by these wider environmental changes and what the prospects are for real, meaningful behavioural changes within the financial industry when the rules and approaches to supervision are in flux for a considerable period of time.

Prudential regulation is an example of management-based regulation, a 'new governance' technique (Black, 2012a; Ford, 2010; Power, 2007) where the bulk of the responsibility for managing economic or societal risks is assigned to corporations. This is done on the basis that they have the capability and willingness to internalize the legal requirements of the regulations and incorporate them into the day-to-day business of organizational life. Prudential regulation is concerned with the regulation of risk management – of the financial and non-financial risks that are inherent in the banking industry. Information and expertise asymmetries between banks and their regulators motivated the decision to allow banks to use their own risk models in the calculation of capital adequacy (Tarullo, 2008; Weber, 2010), and this continued after the crisis, though the rules were tightened to explicitly increase capital requirements. As Chapter 3 described, the prudential rules were amended to improve the quality of capital, introduced a leverage ratio, countercyclical capital buffers and required the monitoring and reporting of liquidity risk for the first time. In addition, as evidenced by both the PRA's documented approach to supervision (Prudential Regulation Authority, 2014b) and the interview participants (see Chapter 6), banks were held to higher standards in the aftermath of the crisis, with more scrutiny of their risk management processes and the PRA's expectations of 'firms to have a culture that supports their prudent management' (Prudential Regulation Authority, 2014e, p. 3).

Banks emphasized the uncertainties resulting from the changes in their regulatory environment, both in their public discourses and during the fieldwork interviews. The sources of this uncertainty varied over time – in 2009, the broad objectives of the regulatory reforms had been articulated by the G20 and the BCBS but details and impacts remained unclear. As the legislative process progressed, the uncertainty associated with the final details of the rules diminished but that related to their ambiguous nature and potential impacts persisted. Banks also appeared to struggle with understanding what comprised a compliant solution, as they experienced the regulator to be more reluctant to give guidance than before the crisis. This thesis has shown how, in order to manage this uncertainty, banks implemented specific structures and practices, effectively transforming uncertainty into a risk (Clarke, 2001; Power, 2007) – the risk of regulatory change.

This final chapter highlights the four key conclusions from this thesis beginning with the argument that the uncertainty and ambiguity of the post-crisis regulatory change amplified the tensions that commonly exist between market and regulatory objectives in a regulated, commercial organization. Operating in a pluralistic institutional environment (Greenwood et al., 2011; Kraatz & Block, 2008; Pache & Santos, 2010) meant that banks still needed to be considered legitimate by multiple external constituencies, especially the market and the regulator. This need to balance the legitimacy demands of these two institutional referents manifested itself in how banks presented their views about regulatory change in public, how they adapted their material practices to manage regulatory risks and how they conducted their relationships with their bank supervisors.

The second major contention is that within banking organizations, the actors most closely involved the management of prudential regulatory change occupied organizational roles which were the embodiment of regulatory logic. These actors were not limited to the Compliance function but spanned several departments, most notably Risk Management, Finance and Regulatory Affairs. These actors comprised a 'community of implementation', an informal grouping coalesced around shared knowledge, skills and expertise and whose importance increased with the increasing regulatory scrutiny after the crisis.

Thirdly, by exploring the routine mechanics of regulatory implementation, this thesis has discovered the considerable amount of organizational work that is required to adapt to external regulatory changes to achieve compliance. Much of this work is focused on acts of sense-making to enable action to be taken, necessary due to the ambiguity of the regulatory rules. This sense-making is also where internal conflicts between market and regulatory demands are negotiated and reconciled, unavoidably resulting in a series of trade-offs between internal constraints of one sort or another and achieving the necessary level of regulatory institutionalization required by management-based regulation.

The final finding concerns the nature of prudential regulation itself, and the prospects for the cultural and behavioural changes required within banks to fully embed these rules in their day-to-day business. The continual development of the prudential regulatory rules, and the significant shifts in how they were supervised by the PRA in the UK, had an inhibiting effect on the degree to which banks were able to institutionalize their compliance with these regulations. Every time the rules were amended, banks had to re-evaluate their existing systems and processes, make the necessary changes and then reintegrate the amended versions into their operational routines. Arguably, however, this is not necessarily damaging to the overall objectives of prudential regulation. Continual redevelopment of the rules and increased levels of supervisory scrutiny result in a greater degree of organizational attention to regulatory change, which, coupled with the increased organizational status of regulatory staff, means that regulation is higher up on the list of organizational priorities. Continuous changes to regulation also make the process of institutionalization harder to achieve.

Managing regulatory change – a balancing act

This thesis used insights from institutionalist organizational theory as a means of understanding how banks responded to the changing regulatory environment. Particularly instructive was the institutionalist conception of organizations operating within a pluralistic environment, meaning that an organization is

> *'embedded within multiple normative orders and/or constituted by more than one cultural logic. It is a participant in multiple discourses and/or a member of more than one institutional category' (Kraatz & Block, 2008, p. 243)*

Applying this view to banks' publicly discussed views about regulatory reform (Chapter 4) and to the material practices and structures put in place to manage this change (Chapter 5), this thesis argues that regulatory change intensifies the tensions that exist between the demands of the market and regulatory requirements, requiring organizations to engage in a continual process of negotiation between two sets of logics. Moreover, the findings show that the weighting given to each logic varied over time in relation to the broader political, economic and social context and in accordance with how each of the institutional logics of the market and regulation were represented internally within the banking organizations.

Chapter 4 presented the analysis of how banks had framed their public discussions about regulatory change before, during and after the financial crisis. It was evident that both market logic and regulatory logic were dominant in the banks' discourse, and whilst deployed simultaneously, the prominence given to each logic respectively changed over time. To explain the changes in the relative weightings of each logic, this thesis drew upon the concept of organizational legitimacy which proposes that organizations are dependent on legitimacy, a kind of 'logic of appropriateness', for their survival and that they will go to great efforts to create, maintain and repair their legitimacy (Suchman, 1995). In a pluralistic institutional environment, organizations have many external referents of legitimacy, each with its own legitimacy criteria. In the case of banks and regulatory change after the financial crisis, it would have been reasonable to expect that banks would be prioritizing the rehabilitation of their legitimacy with respect to their regulators and customers over their shareholders, given the levels of public approbation for the industry at this time (Bennett & Kottasz, 2012; Edelman, 2009, 2010). In fact, the opposite was shown to be the case by the results of the discourse analysis. The use of market logic peaked in the period 2009-2010, and some speculative explanations have been offered for this – such as the banks perceiving a need to pacify or reassure shareholders about the potential impacts of new regulations. Or, it could have been reluctance by the banking industry to accept that many of the tenets of market-based theories had been discredited by the financial crisis. Finally, it may have been a last-ditch attempt to defend the regulatory status quo before acquiescing to the increased stringency of the new regulatory regime.

Alternatively, however, as this thesis argues, the post-crisis regulatory situation was characterized by uncertainty and complexity and for the banking industry in 2010, this was further compounded by the turmoil in market conditions caused by the sovereign debt crisis. Arguably, in such an environment, where significant ideational shifts had occurred (Baker, 2013; Black, 2012b) and policy responses were heavily influenced by broader political changes (especially the election of the coalition government in 2010), determining what the relevant legitimacy criteria even *were* was extremely problematic. Therefore, in line with the theoretical predictions about strategic responses to institutional pressures made by Oliver (1991), in response to a high degree of environmental uncertainty and in an effort to appear in control, banks reverted to well-worn arguments about the adverse effects of higher capital requirements on their profitability and ability to create credit. As regulatory uncertainty diminished from 2011 onwards, banks' views about regulatory change were increasingly expressed in terms of regulatory rather than market logic. During this period, banks were experiencing the more intrusive supervisory approach of the FSA (FSA Practitioner Panel, 2011), which perhaps helped to clarify the criteria to which they needed to conform if they were to regain regulatory legitimacy.

In their public documents, each bank was presenting a singular view about their perspectives on regulatory change. These external representations were the result of deliberate and careful management of an undifferentiated organizational self, especially in the case of the annual reports. A different view of how the banks were adapting to regulatory change was revealed by the fieldwork data which showed there was a degree of dissonance between what the banks *said* about regulatory change and what they were *doing* in response to it. For example, at roughly the same time that banks were publicly stating their concerns about the new rules, the interviewees described how their organizations had begun to implement new governance structures, hire more staff and create new teams specifically for managing regulatory change (see Chapter 5). However, it is an oversimplification to suggest that banks were resisting the new regulations publicly but getting on with achieving compliance internally. The research presented here suggests that the picture was a great deal more complex, again because of how the existing tensions between market and regulatory logic within the banks were exacerbated by regulatory change and uncertainty. This thesis argues that these complexities are demonstrated by the three key findings below.

Firstly, with respect to the internal balancing of market and regulatory logics, this thesis argues that different organizational constituencies or groups of actors were associated with the internal representation of different institutional logics, providing 'organizational members with cognitive templates that influence their perception of which objectives and practices are appropriate' (Pache & Santos, 2010, p. 460). Employees based in Regulatory Affairs, for example, can be thought of as internal representatives of regulatory logic, 'institutional agents' (Scott, 2008) who are involved in a professional project of institutionalization (Suddaby & Viale, 2011). Their day-to-day work focused on promoting conformity with the demands of the institutional logic of regulation. Other organizational actors, such as traders in the Front Office were internal representatives of market logic, focused on maximising profits and minimizing (or 'optimizing') capital requirements. The need to respond to and manage regulatory change required these two sets of institutional agents to come together to make decisions, and to reconcile the conflicting demands of regulation and the market.

Secondly, Chapter 5 showed that these processes of reconciliation manifested in explicit sense-making practices about the risks of regulatory change – the risk of non-compliance or regulatory breaches and the risk of adverse impacts on the firm's financial position. Material practices associated with sense-making included quantitative and operational impact assessments, regulatory rule interpretation and methods for deriving additional benefits from implementation. Organizational sense-making (Weick, 1995) was therefore pivotal in the negotiation of the ongoing settlements between conflicting institutional demands. Such negotiations were rarely articulated by the respondents in these terms but were referred to instead as making decisions about the 'level of compliance' or the way in which a rule could be interpreted to reduce capital requirements. Sociological work on risk and organizations has demonstrated that perceptions and understandings of risk vary within organizations (Hutter, 2001, 2005; Short & Clarke, 1992b). In the case of banks and regulatory change, this thesis contends that differences in perceptions and tolerances of the risks of regulatory change were shaped by the institutional lens through which these risks were viewed. Sense-making processes involving internal representatives of both market and regulatory logics resulted in a prioritization of how these various risks should be mitigated.

Lastly, the intra-organizational decision-making required by this prioritization process was fundamentally political, as the outcome, even if a compromise, reflected to some degree the interests of the most powerful organizational constituency. Prior to the financial crisis, in a climate where market logic dominated not only politics but also regulation (see Chapter 3), the analysis in Chapters 4 and 6 suggested that prudential regulation was not a priority for the banks, other than to implement advanced Basel 2 models to reduce capital requirements. In the words of one interviewee, 'regulatory affairs was a sleepy backwater' (Participant 22, 2014). However, the evidence presented in this thesis points to the increasing power afforded to regulatory professionals after the crisis such as the hiring of more senior staff, the creation of new regulatory teams and functions and increasing remuneration for compliance staff (Oakley et al., 2013). Previous studies have shown that regulatory expertise can be a source of authority within the organization (Edelman et al., 1991; Weait, 1993, 1996), particularly in situations of uncertainty and ambiguity. Control of information has been identified as a key power resource within organizations (Pettigrew, 1972) and the increased levels of regulatory requests from the PRA provided additional opportunities for regulatory professionals to mobilize this resource by acting as 'gatekeepers' of information flowing between the banks and the regulators. Kraatz and Block (2008) claim that in a pluralistic environment, 'a degree of balance may evolve, for instance, as one constituency acknowledges its mutual dependence on another' (p251). Supporting Kraatz and Block's assertion, the interview data revealed that the Front Office (which typically wields the greatest power in a wholesale bank) became increasingly dependent on regulatory professionals with specialist expertise to help them understand and mitigate the impacts of the proposed rules.

However, it should also be recognized that the increased power of regulatory professionals that accompanied regulatory change is also dependent on the broader political and economic context. Creating new structures to manage regulatory change can also be viewed as a signal from banks to their external constituents that regulation is being taken seriously, a strategy to regain or improve their legitimacy position vis-à-vis the regulator. Should the external environment shift back towards 'light-touch' regulation, for example, the status of regulatory professionals might be diminished and the settlements that have been reached between market logic and regulatory logic might be disrupted. Kraatz and Block (2008) warn that 'balances that are struck among various objectives, constituencies and role identities are often precarious' (p. 251) and this thesis has no reason to suggest that this would not also be the case with prudential regulation.

Regulatory professionals and regulatory change

Examining the practices and structures that banks employed to manage post-crisis prudential regulatory change revealed that responsibilities for different aspects of this work were distributed across several parts of these organizations. Studies of financial regulation have sought to understand the role that Compliance Officers, situated within the 'Compliance Function' of a financial organization play in the implementation of regulation (Lenglet, 2012; Parker, 2002; Weait, 1993, 1996). They have been found to be the actors primarily responsible for the interpretation and 'translation' of legal rules, for overseeing their implementation and for monitoring ongoing compliance. Whilst Compliance Officers are still very much present in UK banking organizations, this thesis has found that they play a lesser role in prudential regulation than they do in conduct of business regulation. This thesis therefore attributes the label 'regulatory professionals' to this wider group of employees involved in the management and implementation of prudential regulatory change. The term 'professional' was selected advisedly, following Scott (2008) who suggests that professionals function as 'institutional agents' who are 'definers, interpreters and appliers of institutional elements' (Scott, 2008, p. 223). Compliance Officers are a sub-set of regulatory professionals, with specialist skills and expertise.

Two key arguments are made here about the place that regulatory professionals occupy within organizations in respect of managing regulation in general and regulatory change in particular. The first is that that the existence of a group of regulatory professionals that bridges formal departmental boundaries within an organization and that regulatory knowledge and expertise is suggestive of a community that comes together for the purpose of sense and decision-making in the face of uncertainty and ambiguity. Secondly, regulatory professionals, especially those who manage regulatory relationships, can be viewed as instrumental in the construction and maintenance of an organization's regulatory identity

Chapters 5 and 6 demonstrated that these regulatory professionals possess specialist knowledge essential to the effective management of prudential regulatory change; expertise in quantitative risk models and their associated processes, the capital impacts of the prudential rules, the application of the rules to complex products and transactions or the software used to support risk and capital calculations. In addition, Regulatory Affairs departments were staffed by individuals equipped with specialist relationship management skills and knowledge of the supervisory process, often gained from their previous employment by regulatory authorities. This thesis applies the term 'communities of implementation' to describe these informal networks of regulatory professionals, linked by shared skills and expertise. This term borrows both from Haas' notion of 'epistemic communities' (Haas, 1992) and Wenger's 'communities of practice' (Wenger, 2000). For Haas (1992), epistemic communities are networks of 'knowledge-based experts', sharing similar normative and cognitive beliefs and expertise that influence transnational policy and governance. Like epistemic communities, 'communities of practice' are groups of people who are joined together by shared knowledge and expertise, but they 'grow out of a convergent interplay of competence and experience that involves mutual engagement' (Wenger, 2000, p. 229). Regulatory professionals within banks comprise a similar type of community, having in common the possession of technical knowledge and expertise about prudential regulation. Moreover, because these organizational actors are also institutional agents of regulatory logic, they also share the underlying beliefs, norms and theories of that logic. This is similar to the 'shared repertoire of communal resources available to members of communities of practice' (Wenger, 2000, p. 229).

These communities of regulatory professionals perform important interpretive and sense-making work, using their technical expertise to provide clarity and meaning to the prudential regulatory rules which can be both technically complex and ambiguous (see Chapter 5). This work is important for the organization's ability to implement regulation because it provides a basis for action, for translating regulatory texts from 'conceptual expression to material incorporation into daily routines' (Lenglet, 2012, p. 60). Thus, these groups of regulatory professionals can be thought of as 'communities of implementation', coalesced not only around their expertise but also around specific sets of practices for managing and implementing regulatory change.

Returning to the idea of the pluralistic institutional environment within which banks operate, Kraatz and Block (2008) state that an organization 'possesses multiple, institutionally-derived identities which are conferred upon it by different segments of its pluralistic environment' (p.243). This thesis found that as regulatory scrutiny intensified after the financial crisis, the management of regulatory relationships became more formalized in the sample banks (see Chapter 6). Banks devoted more time and effort to communicative strategies not only to manage or repair legitimacy (Suchman, 1995) but also to construct their regulatory identities (Coupland & Brown, 2004).

Banks and their supervisors are involved in an ongoing relationship of interdependence, each providing the other with relational signals (Etienne, 2012). Actors on each side of the relationship make adaptations in response to the other (Hawkins & Hutter, 1993; Hutter, 1997). Not only does the regulator use these signals to make determinations about regulatory compliance (Hawkins, 1984, 2002), this thesis found that banks also interpret these signals to understand what discourses and practices the regulator deems to be appropriate. This information is then used in the creation or maintenance of a bank's regulatory identity. Chapter 6 argued that regulatory identities are therefore constructed as part of the 'dialectical dance' between the regulator and the regulated. This dance is not performed in isolation but is heavily influenced by the wider political and social environment.

Regulatory professionals play a key role in the careful management of an organization's regulatory identity which becomes even more crucial in times of increased regulatory intensity, such as that which occurred after the financial crisis. Creating and maintaining a particular identity is a considerable challenge for large, complex and fragmented organizations such as banks, which contain constituencies governed by competing or conflicting institutional logics (Kraatz & Block, 2008). Moreover, 'organizations have multiple authors and stakeholders who may produce several and different identity narratives over time. An organizational identity narrative reflects power positions and authorial preferences' (Chreim, 2005, p. 570). In constructing a regulatory identity as part of a legitimacy repair strategy (Suchman, 1995), banks were concerned with presenting a 'united front' to the regulator. Chapter 6 revealed the types of practices involved in this process, such as having an unwritten code of conduct for interactions with the regulator and the careful construction of materials for use in regulatory meetings. This thesis argues that such practices were about constructing and then 'safeguarding' the consistency of the regulatory identity, and that this tended to be the role of actors within Regulatory Affairs departments or in Risk Management teams that had responsibilities for regulatory liaison. In this instance, these regulatory professionals are acting as gatekeepers of their banks' regulatory identity, and once constructed, they employ various discursive practices to ensure that the organization's particular regulatory identity is sustained.

Regulatory implementation and compliance

For large, corporate organizations such as banks, compliance with regulation requires a significant level of preparatory work even before assessments about compliance or non-compliance can be made. Where management-based regulation requires new systems, policies and procedures to be implemented or significantly modified in line with regulatory requirements, as in the case of prudential regulation, this workload is even higher. This thesis has added to existing understandings of the nature of regulatory implementation by revealing the material practices involved in this process – the sense-making and re-organizing that banks undertake to ready themselves for supervisory judgements about compliance. The process of regulatory implementation – the final goal of which regulators consider to be the normalization of compliant behavior within the organization – is not a smooth path. This research has identified several factors which can both help and hinder this endeavour. Moreover, whilst the goal of management-based regulation (and associated techniques) is to effect substantive behavior modification in the target organizations, this thesis contends that determining the degree to which regulated organizations have indeed adopted a substantive rather than ceremonial response to regulatory change is problematic.

Banking organizations engage in a number of practices to prepare for the final goal of compliance with new or changing regulatory rules. Understanding how the rules were changing, establishing what these changes meant for the organization and then executing the corresponding operational modifications were all critical to successful regulatory implementation and achieving compliance. As Chapter 5 suggested, the need for this intensity of activity is largely due to the uncertainties related to regulatory change. These reflect Milliken's three types of perceived environmental uncertainty (Milliken, 1987) – the unpredictability of the changes after the crisis (state uncertainty), the lack of clarity over their impacts (effect uncertainty) and the lack of guidance with regards to the correct response (response uncertainty).

For UK banks, managing regulatory change and implementing regulation was not just about achieving compliance, even though the findings are suggestive that was indeed one of their goals. It was also about understanding and mitigating the potential adverse impacts on their company's financial performance. As discussed above, additional work was therefore required by these organizations to resolve these tensions and conflicts between various organizational constituencies, involving many acts of sense-making and negotiation all of which had to be accomplished within the deadlines set by the regulatory authorities. These tensions and conflicts, and the uncertainties also required a number of compromises or trade-offs.

There were tensions between the availability of the final detailed rules and the time that remained for regulatory implementation, a trade-off between certainty and time. Given finite resources, a limited timeframe for regulatory implementation and a lack of *ex ante* regulatory guidance, there was a conflict between achieving a certain level of compliance to meet the deadline whilst acknowledging that adaptions may fall short of supervisory expectations. This is a trade-off between available resources and achieving a greater degree of compliance. Some organizations also postponed the development of strategic and long-lasting technology solutions and put in place short term tactical solutions because of the lack of certainty, the immovable deadline and resource constraints. This was a trade-off between achieving regulatory compliance versus making long term, strategic changes which are more likely to facilitate the institutionalization of regulation. Finally, banks potentially had to make decisions as to where best to assign resources – whether to devote more time, effort and money to making changes that would mitigate the potential economic impacts of the new rules, or whether to allocate resources to achieve the best level of compliance (assuming this is possible to determine). This thesis therefore contends that an organization's capacity to comply depends not only on its motivation and resources, it also depends on its ability to navigate the uncertainties in an unstable environment and to balance compliance with other organizational constraints.

New governance techniques, such as management-based regulation (Coglianese & Lazer, 2003; Ford, 2008; Gilad, 2010; Gunningham & Sinclair, 2009; Hutter, 2011c), rely on the ability of regulated organizations to embed compliance with regulatory standards in their organizational routines. In doing so, the intention is that conformity with regulation permeates not just the material policies, processes and IT systems but also the less tangible aspects of organizational life. Neo-institutional theorists refer to these aspects as 'cultural-cognitive', the informal beliefs and values that become taken-for-granted and constrain cognition (Scott, 2007). In other words, the full institutionalization of regulatory logic requires a cultural shift as well as material changes for substantive compliance to be achieved. A set of inhibiting factors uncovered by this study suggest that in the case of prudential regulation, this is unlikely to become an empirical reality until the prudential rules are stabilized for a period of time. Some of these factors confirm existing findings about firms' capacity to comply, which argue that the availability of financial and non-financial resources is an important determinant of regulatory capacity (Borck & Coglianese, 2011; Gray & Shadbegian, 2005; Howard-Grenville et al., 2008; Winter & May, 2001). Chapter 7 found that a lack of financial resources manifested in inadequate prior investment in computer systems and data management techniques which frustrated attempts to operationalize the changes required for Basel 3 compliance. However, following the crisis, representatives from the participating banks reported significant increases in budgets for regulatory implementation, with the constraints on capacity stemming more from shortages of expertise and time rather than money. This was corroborated by reports of skill shortages and rising salaries for regulatory and compliance staff (Arnold, 2014; Enver, 2014; Oakley et al., 2013).

Of greater significance were limiting factors external to the banks. Foremost of these, once again, was the uncertainty that had pervaded the regulatory environment since the financial crisis. Uncertainty about the content of the regulatory rules, supervisory expectations and regulatory deadlines all contributed to the banks' sense of trying to implement a moving target. Each time the regulatory rules were changed, even if the changes were minor, banks engaged once again in the cycle of sense-making, design, and implementation. This continuous cycling is unlikely to cease until the regulatory goalposts stop moving and the Basel rules stop changing. Until then, the prospects for the full institutionalization of prudential regulation (and therefore substantive compliance) are slim.

Regulatory literature and neo-institutional organization theory both draw attention to the fact that regulatory compliance or conformity to institutional pressures is not necessarily always substantive (Bromley & Powell, 2012; Edelman et al., 1991; Meyer & Rowan, 1977; Oliver, 1991). Instead of firms making adaptations to their core activities in response to regulatory pressures, they may portray a semblance of conformity but actually, these changes are 'decoupled' from the routine activities of the organization. Decoupling, as a type of avoidance (Oliver, 1991) is just one of the multiple strategies of response available to organizations but is prominent in regulatory studies. Parker and Gilad (2011) ask whether it is even possible to identify characteristics or motivations that can help to distinguish between companies implementing compliance systems as a substantive response to social goals and those who adopt a more calculated response of ceremonial compliance (Parker & Gilad, 2011, p. 189). This thesis confirms this view, recognizing the difficulties involved in distinguishing between ceremonial and substantive responses to regulatory change.

In Chapters 5 and 7, this study demonstrated that banking organizations have elaborated existing or created new structures for managing regulatory change. The presence of these structures alone does not necessarily imply that these same organizations are implementing substantive material modifications to bring them into regulatory conformity. Edelman (1992), in the context of equal opportunity law, stated that 'organizations respond to law by creating new offices, positions, rules and procedures…as visible symbols of their attention to [equal opportunity] issues and their efforts to comply' (p1542). Such 'structural elaboration' does not necessarily guarantee substantive change. Indeed, as Chapter 7 concluded, looking to structures alone to determine the degree to which regulatory logic has been institutionalized is not sufficient because structures do not reveal the cultural-cognitive aspects of institutions, the 'shared conceptions that constitute the nature of social reality and the frames through which meaning is made' (Scott 2008 p7).

Over and above these empirical limitations, however, the findings in this thesis indicate that organizations do not consistently adopt the same response to regulatory change over time. Compliance is not a one off event but is a process that occurs over time and within a broader political and social context (Edelman et al., 1991, p. 74). Changes in the regulatory environment will have a bearing on whether compliance is ceremonial or substantive or even somewhere in between. In addition, in large and complex organizations such as banks, it is possible for multiple compliance strategies to co-exist because of the multiple internal constituencies embodying or representing different institutional logics.

Moves from ceremonial to substantive compliance are also influenced by the wider political environment. Ceremonial compliance is more likely in situations where regulatory enforcement is weak (Edelman, 1992; Meyer & Rowan, 1977). Regulatory authorities may be under-resourced and unable to adequately surveil their regulatees. Or, as in the case of the FSA, the government may exert political pressure to maintain low levels of regulatory scrutiny. When this changed after the financial crisis, supervisory expectations toughened and were more demanding of banking organizations to demonstrate substantive compliance. Banks had to be able to provide detailed data for their supervisors to analyze and question, requests that would have been problematic to fulfil without having implemented the compliant systems and processes. Given that that this more intrusive regulatory approach resulted in increased levels of inspection and evaluation, strategies of decoupling or ceremonial compliance were less likely to be successful (Meyer & Rowan, 1977) so it was unlikely that banks would have moved from a position of substantive compliance to one of ceremonial compliance but that is not to say that this is not possible, especially if relations between the UK government and the banking industry continue to thaw. Finally, Suchman and Edelman (1996) argue that the conflicting institutional demands of the banks' external environment combined with a high degree of uncertainty may mean that ceremonial compliance is the only possible response because 'it is often easier to proclaim flexibility, efficiency, aggressiveness, accountability and impartiality in ceremony than to be all of these things in practice' (Suchman & Edelman, 1996, p. 921). Uncertainty then, might make substantive compliance and the institutionalization of regulation more difficult, putting at risk the ability of prudential regulation to achieve financial stability.

The irony of prudential regulation?

Prudential regulation is fundamentally about the control of risk within the financial system. A consistent theme throughout this thesis has been the uncertainty of the post-crisis regulatory environment. This thesis argues that there are inherent features of the prudential regulatory regime that cause uncertainty, which is exacerbated further when it undergoes significant reform. Banks considered regulatory change to be one of the key risks they faced during the research period, posing threats to both their future financial performance and their ability to achieve compliance with the new rules. As discussed above, the prospects for the institutionalization of prudential regulation were, rather ironically, undermined by the regulatory reform process following the crisis. This section discusses the features of prudential regulation which create uncertainty and lead to this apparent paradox. These are: the unpredictability of supervisory judgements with respect to mandatory adjustments to levels of regulatory capital, changing supervisory expectations with regards to compliance which are not enshrined in rules and the standard setting process itself. However, a more optimistic perspective on regulatory institutionalization is also offered in that whilst the institutionalization of the regulatory rules themselves is inhibited by continual change, the processes and practices of managing regulatory change are increasingly becoming normalized within the banking industry, effectively increasing organizational attention to regulation.

Prudential regulation relies on harnessing a bank's own risk management capacity as a means of safeguarding financial stability. At the same time, the prudential rules governing banks are very prescriptive, with precise criteria for the measurement and calculation of minimum capital requirements. The prudential rules require banks to implement what amounts to a complex and dynamic control system, comprising various measures that can be altered or recalibrated to increase or decrease a banks' regulatory capital requirements. A seemingly small adjustment to one of these measures can have a large impact, such as the application of multipliers to the risk model outputs or the removal of regulatory approval to use a risk model for a particular class of products. Like policies such as price fixing in the energy markets, prudential rules can have a fundamental impact on a banks' financial position. If bank supervisors such as the PRA are not satisfied by the robustness of a bank's risk management framework and capital calculation mechanisms, it can use the various measures in that bank's prudential control system to increase its regulatory capital requirements. In extremis, the PRA also has the power to remove previously granted permissions to use internal risk models or even remove approvals to participate in certain product markets (Prudential Regulation Authority, 2014b). This gives the supervisors the discretion to exercise judgement rather than using a more 'tick-box' approach. It therefore adds a level of unpredictability into the supervisory process from the bank's perspective, compounding the uncertainty already present in their regulatory environment.

Chapter 3 described how the prudential standards set by the BCBS have continued to change since they were first introduced since 1988. The pace and volume of this change increased further in response to the global financial crisis and the BCBS is still working through additional reforms (BCBS, 2014d). It is not just the content of the rules that have changed, the assumptions and theoretical beliefs about prudential regulation also shifted (Baker, 2013; Moloney, 2012). Regulatory objectives also altered, particularly those about what constitutes adequate levels of capital in the financial system. Whilst the move from Basel 1 to Basel 2 was intended to keep levels of capital across the financial system relatively stable, Basel 3 explicitly aimed to increase capital levels. These ideological shifts and changing regulatory objectives affected the supervisory philosophy, with regulators such as the PRA raising their expectations of compliance even if the rules themselves were unchanged. Again, this exacerbated the uncertainty associated with the supervision and enforcement of the prudential rules. These expectations were not written into the reformed standards but were communicated during the routine regulatory interactions between banks and their supervisors (Chapter 6). Finally, the legislative mechanisms through which the global BCBS standards were translated into EU or national law also contributed to the uncertainty experienced by the banks. Each draft of rule changes initiated the cycle of sense-making, planning and implementation within the banks, resulting in the types of compliance trade-offs discussed above.

Whilst this iterative implementation process was no doubt costly for the banks, it is not necessarily the case that navigating this high level of uncertainty was harmful in terms of meeting the objectives of prudential regulation. By requiring banks to engage deeply in practices of sense-making and interpretation, the uncertainty of regulatory change necessitated a dialogue between the 'institutional agents' of market and regulatory logics within banking organizations. Possibilities for reconciliation and accommodation were found through particular risk management practices, such as the setting of risk appetite or strategies for deriving business benefits from compliant activities. It can be argued that a greater degree of regulatory change *and* increased regulatory intensity leads to greater organizational attention to regulation. The irony of prudential regulation then, is that whilst the possibilities for the institutionalization of the new prudential standards are thwarted somewhat by their continual state of flux, an institutionalization of a different sort is encouraged. This is the institutionalization of the management of regulatory change, an acceptance by banking organizations that regulation has become part of 'business as usual'.

Reflections on the limitations of the study

Many of the limitations of this thesis are methodological and relate in part to the sensitivity of the topic of regulation and problems of gaining access to people within the financial services industry. Additionally, some aspects of how regulated organizations manage regulatory change could only be partially explored because of the nature of the research design. This section explores these issues and suggests ways in which they could be addressed through triangulation with other methods, gathering additional data or being examined from a different perspective.

As explained in Chapter 2, the selection of respondents for this research was primarily based on access and snowball sampling (Bryman, 2015) given the difficulties of negotiating access. Despite attempts to include representatives from other areas of the banks, the sample was limited to organizational members from risk management, finance and regulatory departments. Whilst these interviewees provided rich data regarding the practices of managing regulatory change and managing interactions with the banking supervisors, this study could be extended in two directions. Firstly, the same types of interview questions could be asked of organizational actors from the Front Office to see how they responded to regulatory change, and how their perceptions of regulation had changed since the financial crisis. Employees in the Front Office are primarily focused on revenue-making activities and incentivized through their remuneration to maximize profits, practices associated more with market than regulatory logic. Extending this research project in in this manner could explore the extent to which these actors considered regulatory change in terms of market logic and how they approached the process of negotiating priorities with the regulatory professionals in their organization. It would have been instructive, therefore, to investigate their responses to regulatory change and how, as agents of market logic, they perceived the challenges of the changing regulatory environment and its associated uncertainty.

Secondly, increasing the number of interviews in each sample bank would help to explore some of the more tentative findings presented in this thesis. For example, the literature on managing risk in organizations (Short & Clarke, 1992a; Turner & Pidgeon, 1997; Vaughan, 1992) suggests that the communication of risk (and possibly regulatory) information within complex organizations is problematic. This did appear to be the case for the organizations in this study where responsibilities for managing regulatory change were very fragmented but there were only one or two examples of where this had caused difficulties. Similarly, the existence of apparently comparable categories of regulatory management practices across five organizations is suggestive of a degree of isomorphism (DiMaggio & Powell, 1983), but more data would be required to make a this a stronger claim. Finally, in the interviews, even though there was a degree of consistency of explanations for the greater degree of preparation for regulatory interactions, the sample was too small to realistically confirm the respondents' claims that this was to ensure accurate and complete information was given to the PRA, rather than actors within the banks 'spinning' this information to show them in the best light. Whilst attempts were made to recruit additional participants, this proved to be very difficult given the sensitivity of regulatory issues in 2013-14. Perhaps when the pace of regulatory change slows or the regulatory climate becomes less politicized, this may prove to less problematic.

From the exploration of the material practices involved in regulatory change, it was clear that a large amount of organizational work is required to implement regulatory changes, translating the 'law on the books' to the 'law in action' within specific concrete contexts. In a particularly complex and technical domain, such as prudential regulation, this requires multiple decisions and assumptions at every step of the process. Not only do these decisions have to balance conflicting organizational priorities but they also have to navigate practical and technological constraints that policy-makers may not have anticipated when creating the written texts. Despite several respondents mentioning some examples of this they encountered in their work, there was not enough data to draw any conclusions about how these processes might impact the achievement of regulatory compliance in the banking industry. Understanding the more detailed mechanics involved in this process, such as how regulatory rules are rendered into computer code or how existing processes are amended to include regulatory requirements would require would require ethnographic methods. Participant observation would reveal the myriad micro-decisions and processes necessary to implement regulation and would highlight how tensions between conflicting logics were reconciled at this very detailed level to achieve compliance. This approach would also help to resolve the difficulties outlined above with respect to distinguishing between ceremonial and substantive compliance.

Finally, the fieldwork for this thesis was conducted over the course of a year and required interview participants to reflect on the regulatory changes they had observed over the previous five to six years. The data therefore reflected the interviewees' views about retrospective events at a specific point in time. Two implications follow from this. The first is the possibility that their recollections were not entirely accurate, or were made sense of given their experiences and knowledge at the time of the interviews. Secondly, and more importantly, this did not allow for a direct comparison of their views of the situation with regards to regulatory change before and after the financial crisis. To make such a comparison would require a longitudinal study, with interviews conducted before and after the trigger for regulatory change. Obviously, without the gift of foresight, it is difficult to predict another financial crisis that might act as a trigger for regulatory change but other, less dramatic triggers such as changes in government, or new regulatory initiatives in response to emerging risks are often signalled in advance.

Implications for future research

The focus of this research project has been the organizational practices and processes and the interpersonal interactions that banks engaged in to manage and respond to the post-crisis changes in prudential regulation. Prudential regulation is designed to keep the banking system safe and stable and when this fails, as the financial crisis demonstrated, the economic and social costs are high. The effectiveness of these rules in maintaining financial stability lies in part in their effective implementation within individual banking organizations. How banks make sense of these rules, how they adapt their internal practices and structures and how they interact with the supervisory authorities all contribute (or not) to the strength and soundness of the global financial system. The way that prudential regulation is designed puts the onus of prudent risk management onto the banks themselves and, as such, requires banking organizations to internalize a set of norms, values and practices that are part and parcel of everyday organizational life. Exploring these seemingly innocuous, routine and quotidian mechanics in this thesis has revealed some fundamental implications for sociological and socio-legal work on organizations, risk and regulation.

In 2015, after the fieldwork was completed, there were indications that politicians in the UK were beginning to take a more moderate attitude towards the City in 2015, talking of a ‘new settlement with financial services’ (HM Treasury & Osborne, 2015). If this heralded a reduction in political pressure for the PRA and FCA to be tough on the banks, it is likely that the regulatory pendulum could swing back the other way, towards less stringent and intrusive supervision. If this were to happen, the findings in this thesis suggest three possible consequences. The first would be that banks dedicate less time, effort and attention to regulation in general, diverting resources away from regulatory implementation and into profit-making activities. Secondly, with less intensive scrutiny, opportunities for evasive responses to regulation grow, resulting in an increase ceremonial compliance. Thirdly, regulatory professionals are likely to experience a reduction in their organizational status, frustrating their attempts to maintain co-operative regulatory relationships and reducing their ability to institutionalize regulatory logic throughout the organization. The ultimate result might not be another financial crisis, given that the regulatory rules have also been strengthened but it would signal a return to the dominance of market logic, and potentially pose an increased risk to financial stability.

For banks, managing the post-crisis regulatory changes has primarily been a matter of decision-making under conditions of uncertainty. These decisions ranged from the detailed interpretation of a single rule to determining how to reconfigure their business models to mitigate the increased capital requirements. Furthermore, this thesis has found that this high degree of uncertainty inhibits a bank's ability to institutionalize the requirements of prudential regulation and that this is because of the intrinsic features of this regulatory regime. In other words, by mandating behavioural and normative changes to reduce the risks of financial firms failing, prudential regulation has the potential to be self-defeating if some of the factors which cause this uncertainty are not addressed. Standard setters therefore need to be mindful of the balance between continual attempts to improve the design of prudential regulation and the ability of banks to fully embed the regulatory requirements whilst they are in a state of flux. There is a bigger question here though, and that is whether this creation of uncertainty is an inherent problem of management-based regulation in general (and other 'new governance' techniques) and if so, what the options are to tackle this without undermining the rationale for using such techniques in the first place. That is not to say that there is no uncertainty associated with more traditional 'command and control' - firms also struggle to understand how to achieve compliance with this type of regulation. However, with management-based regulation, uncertainty is further compounded by the lack of prescriptive criteria for rule compliance and a lack of clarity regarding supervisory judgements. This is a problem which requires further theoretical and empirical attention, potentially in other regulatory domains.

The worst financial crisis in nearly a century was in part a failure of regulation, and this triggered the need for the regulatory changes that have been considered. This research has demonstrated the sheer volume and types of work involved in the internal processing of this regulatory change – the effort involved to focus organizational attention on what needs to be done, the high degree of sense-making and re-organizing that is required, as well as the significant levels of human and financial resources this involves. Of course, changes to regulatory regimes do not always occur as a result of regulatory failure. The regulatory environment is difficult to separate from the political system and significant events in the latter are bound to have an effect on the former. The impact of the vote by the UK to leave the European Union in June 2016 is, at the time of writing, extremely unclear. As this thesis has shown, the prudential regulatory regime that is currently operating in the UK is enshrined in EU law and there is no indication yet how or if this situation is likely to change. In this next moment of great uncertainty for banks in the UK, this research implies that internal institutional tensions may once again be exacerbated, the resources, skills and expertise to navigate this terrain will become even more scarce and regulatory institutionalization could be even more difficult to achieve.

Appendix 1 – Discourse analysis corpus

Bank	Document	Year
Barclays	Annual Report	2006
Barclays	Annual Report	2007
Barclays	Annual Report	2008
Barclays	Annual Report	2009
Barclays	Annual Report	2010
Barclays	Annual Report	2011
Barclays	Annual Report	2012
Barclays	Annual Report	2013
HSBC	Annual Report	2006
HSBC	Annual Report	2007
HSBC	Annual Report	2008
HSBC	Annual Report	2009
HSBC	Annual Report	2010
HSBC	Annual Report	2011
HSBC	Annual Report	2012
HSBC	Annual Report	2013
Lloyds	Annual Report	2006
Lloyds	Annual Report	2007
Lloyds	Annual Report	2008
Lloyds	Annual Report	2009
Lloyds	Annual Report	2010
Lloyds	Annual Report	2011
Lloyds	Annual Report	2012
Lloyds	Annual Report	2013
RBS	Annual Report	2006
RBS	Annual Report	2007
RBS	Annual Report	2008
RBS	Annual Report	2009
RBS	Annual Report	2010

Bank	Document	Year
RBS	Annual Report	2011
RBS	Annual Report	2012
RBS	Annual Report	2013
Standard Chartered	Annual Report	2006
Standard Chartered	Annual Report	2007
Standard Chartered	Annual Report	2008
Standard Chartered	Annual Report	2009
Standard Chartered	Annual Report	2010
Standard Chartered	Annual Report	2011
Standard Chartered	Annual Report	2012
Standard Chartered	Annual Report	2013
Barclays	BCBS: International Framework for Liquidity Risk Measurement, Standards and Monitoring	Apr-10
Barclays	BCBS: Strengthening the resilience of the banking sector	Apr-10
Barclays	EC: Possible Further Changes to the Capital Requirements Directive (CRD4)	Apr-10
Barclays	EC: Consultation on countercyclical capital buffers	Nov-10
Barclays	BCBS: Capitalisation of Bank Exposures to Central Counterparties	Feb-11
Barclays	EC: Possible measures to strengthen bank capital requirements for counterparty credit risk	Mar-11
Barclays	BCBS: Fundamental Review of the Trading Book First Consultation Paper	May-12
Barclays	BCBS: The non-internal model method for capitalising CCR exposures	Sep-13
Barclays	BCBS: Fundamental Review of the Trading Book Second Consultation Paper	Oct-13
Barclays	PRA: CP05/13 Strengthening Capital Standards: Implementing CRD4	Oct-13
HSBC	BCBS: International Framework for Liquidity Risk Measurement, Standards and Monitoring	Apr-10
HSBC	BCBS: Strengthening the resilience of the banking sector	Apr-10
HSBC	EC: Possible Further Changes to the Capital Requirements Directive (CRD4)	Apr-10
HSBC	EC: Consultation on countercyclical capital buffers	Nov-10
HSBC	BCBS: Fundamental Review of the Trading Book First Consultation Paper	May-12

Bank	Document	Year
HSBC	BCBS: Fundamental Review of the Trading Book Second Consultation Paper	Oct-13
HSBC	PRA: CP05/13 Strengthening Capital Standards: Implementing CRD4	Oct-13
Lloyds	BCBS: Strengthening the resilience of the banking sector	Apr-10
Lloyds	EC: Possible Further Changes to the Capital Requirements Directive (CRD4)	Apr-10
Lloyds	PRA: CP05/13 Strengthening Capital Standards: Implementing CRD4	Oct-13
RBS	BCBS: International Framework for Liquidity Risk Measurement, Standards and Monitoring	Apr-10
RBS	BCBS: Strengthening the resilience of the banking sector	Apr-10
RBS	EC: Consultation on countercyclical capital buffers	Nov-10
RBS	BCBS: Capitalisation of Bank Exposures to Central Counterparties	Feb-11
RBS	EC: Possible measures to strengthen bank capital requirements for counterparty credit risk	Mar-11
RBS	BCBS: Fundamental Review of the Trading Book First Consultation Paper	May-12
RBS	BCBS: The non-internal model method for capitalising CCR exposures	Sep-13
RBS	BCBS: Fundamental Review of the Trading Book Second Consultation Paper	Oct-13
RBS	PRA: CP05/13 Strengthening Capital Standards: Implementing CRD4	Oct-13
Standard Chartered	BCBS: Strengthening the resilience of the banking sector	Apr-10
Standard Chartered	EC: Possible Further Changes to the Capital Requirements Directive (CRD4)	Apr-10
Standard Chartered	EC: Consultation on countercyclical capital buffers	Nov-10
Standard Chartered	BCBS: Capitalisation of Bank Exposures to Central Counterparties	Feb-11
Standard Chartered	EC: Possible measures to strengthen bank capital requirements for counterparty credit risk	Mar-11
Standard Chartered	BCBS: Fundamental Review of the Trading Book First Consultation Paper	May-12
Standard Chartered	BCBS: The non-internal model method for capitalising CCR exposures	Sep-13
Standard Chartered	PRA: CP05/13 Strengthening Capital Standards: Implementing CRD4	Oct-13

Appendix 2 – Interview guide

1. Opening the Interview

Scene setting and introductions

2. Background to the organization and the interviewee

2.1 To begin with, could you please tell me a little about the function you work in for Bank X and also about your role in particular?

Probe for:

- Size of their function (number of people)
- Seniority
- Participation of the function in regulatory-related activities, particularly Basel 2&3
- Interaction with other regulatory functions
- Previous roles

3. Managing the Regulation

3.1 What do you consider to be the main changes in the regulatory environment since 2008?

Probe for

- Changes with biggest impact and why
- Rules
- Approach
- Structure

3.2 Has this affected how you manage the capital adequacy (Basel 2&3) regulations and if so, how?

Probe for:

- Changes in number of resources directly involved in regulatory activities, number of people indirectly involved
- Changes to systems / processes / standard operating procedures

3.3 What are some of the key challenges you have encountered in managing these regulations since 2008? How have you overcome these challenges?

4. Managing the Regulator

4.1 How is the relationship with the FSA (PRA) managed in your organization?

Probe for:

- Strategy for managing the relationship with the regulator

- Who interacts with the regulator and in what capacity?
- Does the participant have contact with the regulator? If so, in what capacity and which part of the Regulator? Who? What level of seniority?
- Is the relationship actively managed? How?
- What would cause something to be escalated to more senior levels (either in your organization or to the regulatory organization)?
- How has this changed over time?

4.2 What is the nature of the interaction with the Regulator? How are meetings with /information requests from the regulator dealt with in your organization?

Probe for:

- Types of questions that the regulator asks / agenda items
- Processes for dealing with information requests / meetings
- Ad hoc vs regular information requests and what is included
- Decisions about what information should be presented to the regulator
- Type of interaction – face to face, email, formal letters
- Who visits? Changed?
- Nature / character of interaction – hostile, amenable etc.
- Changes over time?

4.3 Can you describe any additional changes that you have noticed in managing the interaction with the FSA / PRA since 2008? What are the main challenges involved in the interactions with the FSA / PRA?

5. Conclusion

5.1 Is there anything I haven't asked about that you wanted to tell me?

6. Wrap up, next steps and thanks.

Appendix 3 Coding framework - indicators of regulatory institutionalization

<table>
<tr><th>Indicator Category</th><th>Institutionalization Indicators</th><th>Model Stage</th></tr>
<tr><td rowspan="8">Systems and Procedures</td><td>Training regarding regulatory changes</td><td>Design & Establishment</td></tr>
<tr><td>Regulation driving change</td><td>Operational</td></tr>
<tr><td>Changes to processes</td><td>Design & Establishment</td></tr>
<tr><td>Changes to policies</td><td>Design & Establishment</td></tr>
<tr><td>Changes to risk models</td><td>Design & Establishment</td></tr>
<tr><td>Implementing manual solutions</td><td>Design & Establishment</td></tr>
<tr><td>Changes to IT Systems</td><td>Design & Establishment</td></tr>
<tr><td>Changes to internal controls</td><td>Design & Establishment</td></tr>
<tr><td rowspan="12">Governance and Structures</td><td>Seniority of regulatory managers</td><td>Operational</td></tr>
<tr><td>Re-organising for regulatory change</td><td>Design & Establishment</td></tr>
<tr><td>Regulatory change programmes</td><td>Design & Establishment</td></tr>
<tr><td>New team or personnel to manage regulatory relationships</td><td>Design & Establishment</td></tr>
<tr><td>New governance structures to manage regulation</td><td>Design & Establishment</td></tr>
<tr><td>Monitoring ongoing compliance with regulation</td><td>Normalization</td></tr>
<tr><td>Internal communication of regulatory issues</td><td>Operational</td></tr>
<tr><td>Increased levels of regulatory expertise in bank</td><td>Operational</td></tr>
<tr><td>Increase levels of staff to deal with regulatory change</td><td>Design & Establishment</td></tr>
<tr><td>Implementation of regulation</td><td>Design & Establishment</td></tr>
<tr><td>Approach to regulatory implementation</td><td>Design & Establishment</td></tr>
<tr><td>Hiring ex-regulatory personnel</td><td>Design & Establishment</td></tr>
<tr><td rowspan="8">Integration into Business Practices</td><td>Mandatory regulatory reporting</td><td>Operational</td></tr>
<tr><td>Regulation impacts business strategy</td><td>Normalization</td></tr>
<tr><td>Regulation as part of day to day business operations</td><td>Normalization</td></tr>
<tr><td>Provide regulatory advice to business on ongoing basis</td><td>Operational</td></tr>
<tr><td>Other uses of regulatory driven changes</td><td>Operational</td></tr>
<tr><td>Increased budget for regulatory purposes</td><td>Operational</td></tr>
<tr><td>Change business operations to use capital most efficiently</td><td>Operational</td></tr>
<tr><td>Management of capital requirements</td><td>Operational</td></tr>
<tr><td>Knowledge and Commitment</td><td>Senior management focus on regulation</td><td>Design & Establishment</td></tr>
</table>

Indicator Category	Institutionalization Indicators	Model Stage
	Risk measures part of performance measurement	Operational
	Organisational attention to regulatory change	Operational
	More time spent on regulatory matters	Operational
	Importance of taking regulatory change seriously	Operational
	Increased levels of regulatory knowledge in the wider organization	Design & Establishment
	Explaining changing regulatory environment to business	Operational
	Change to bank regulatory culture	Normalization

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