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Appendix to the Volume: Questions for Further Research

The articles in this volume analyze the role of corporate culture and governance in the banking industry. The authors take a variety of approaches to the topic, summarizing and synthesizing the literature, providing case studies to illustrate key issues, and developing a framework for understanding the importance of culture and governance to risk management and financial stability. Numerous questions remain, however. Many are asked in the articles themselves, while additional areas of inquiry are detailed below.

A prerequisite to establishing an effective culture and proper governance in financial firms is the ability to identify and explain weaknesses in the structure and behavior of organizations. To conduct such an assessment, a two-pronged approach is essential. Purely data-driven analysis can help us distinguish between competing causal models, but qualitative analysis can stretch the boundary of possible explanations. Therefore, instead of limiting research to the analysis of large data sets, I advocate qualitative research that would explore the relative importance of the right outcome versus the right process—whether knowing *what* is done (the outcome) is ultimately as important as understanding *how* and *why* it is done (the process). If we don't understand the process, there can be no learning, which hinders our ability to avoid future crises. Further, I recommend research into directors' understanding of governance in relation to their own role, as well as the ways in which their understanding evolved as a result of their unique experiences at the helm of institutions during the crisis. Still, like quantitative analysis, qualitative research tells only half the story; it can shed light on the unknown—illuminating what we didn't know we didn't know—but it cannot test hypotheses. Therefore, it is important to draw upon the strengths of both approaches for a complementary combination of exploration and analysis.

Governance Questions

1. How can more detailed governance proxies and the inclusion of private banks in our research add to our knowledge of governance and our ability as regulators to spot dysfunctional firms?
2. How are board and governance structures different for public and private banks?
3. How do governance structures differ across legal categories of incorporation (for example, S- and C-corporations or mutual holding companies)?
4. How well do proxies for S- and C-corporations predict failure? Do they have more or less explanatory power over time? And across institutions?
5. What drives changes in governance structure over time? What are the implications of these changes for the performance and risk appetites of firms?
6. How closely do regulators' assumptions about the role of directors track with what is actually reported by directors?
7. According to the law, the boards of banking firms are shareholders' first line of defense. Is this expectation realistic, particularly for financial firms? How can board oversight be improved?
8. An important channel in governance is shareholder activism. Why is there so little activism in the banking industry? Is activism desirable even if it produces asset volatility and instability in management? If so, how might activism be encouraged?

9. If activism is so weak, shouldn't the punishments for abuse be imposed on management rather than on the firm (stockholders)? If so, should we worry about the labor market for management?
10. Is there a role for creditor activism in the banking sector—for example, with the introduction of bail-in-able debt? Should creditor activism be encouraged?
11. It has been suggested that corporations focus on the short term in response to exogenous forces such as pressure by institutional investors. How should banks respond to these kinds of external demands as their governance is shaped by market forces (as well as supervisory guidelines)?
12. Some observers argue that banks should focus on long-term value rather than short-term returns. What is long-term value in the banking context given the maturity terms of bank assets and liabilities?
13. If long-term objectives and value can be defined, then what employee compensation structure could support those objectives?

Survey of Directors

Input from individuals who were directors of banks during the crisis could add insights. Without asking these questions of directors themselves, we cannot identify problems in motivation or reasoning. However, by conducting surveys of directors, we would be able to ask questions that are strictly unanswerable with current data, such as:

1. How much heterogeneity is there in risk appetite among directors and firms?
2. How do directors think about managing risk, and where do they believe the biggest problems lie?
3. In the period before the crisis, did the firm take risks that in hindsight were unmanageable but that had previously been calculated, reported, and approved by the board? If so, what incorrect assumptions were made about the character of the risk? If not, where was the breakdown in the governance structure that allowed the risk to be taken?
4. What could directors have done to avert distress or failure? What kept them from doing so at the time?
5. Given their experience during a time of distress, what would directors have done differently?
6. What recommendations do directors of firms that survived the crisis have for boards of financial institutions today?

Supervisory Questions

Regulators approach governance as a means of protecting the public from downside risk to institutions and catastrophic loss to the financial system as a whole. However, it remains unclear how directors of different institutions conduct their internal risk/return analysis. From the regulatory vantage point—from outside the firm—if we observe ex post that firms took on what was revealed to be excessive risk, it is difficult to know whether the governance structure of the firm was just not strong enough to withstand the pressure of a few risky individuals, or whether that structure was carefully calibrated for the firm to take large gambles. I outline below a few questions for supervisory consideration.

1. When setting regulatory best practices and encouraging firms to improve governance, should regulators focus on outcomes or processes?
2. What kinds of governance processes are in place at the bank, and are they board- or CEO-directed?
3. How can governance processes reveal the state of governance within a firm? How do supervisors decide that bank governance is ineffective?
4. How could supervisory interaction with the board identify potential problems and types of weaknesses in board oversight? What questions need to be raised by supervisors in order to achieve this result?
5. How do we determine where the disconnect lies between final outcomes that are considered "good" and processes that are not?
6. What board procedures should regulators encourage to make firms better governed?
7. How would regulators like directors to perceive their interaction with the board, and how would regulators like directors to weigh various considerations as they make particular decisions?

Culture Questions

1. Is culture different in the financial services industry? Is there a higher incidence of abuse, fraud, and inadequate risk management in financial firms than in firms in other industries?
2. If so, what are the contributing factors? Asset structure? Asset opacity? Labor market issues and self-selection? Reward structure? Others?
3. In light of the effect of abuse on financial stability, should banks and banking firm employees face a more severe punishment (monetary, legal, or both) for abuse than nonfinancial institutions and their employees?
4. Can a higher level of disclosure and transparency improve culture? Should we promote this increased transparency, even though the decision to increase transparency is one that would be difficult for banks to unmake in the future without repercussions?
5. How can regulators improve the flow of information within banking firms—from management to the board, for example?
6. How can we induce a culture of cooperation with regulators, such as the sharing of information in real time?
7. How do we define a good culture and how do we know when we see it? What are the attributes of a good culture?
8. How can culture be changed? What would be the evidence of such a change?
9. Equilibrium between governance and culture at a firm is the outcome of market forces as well as regulatory forces. What should regulators do to improve bank cultures? How do we know when we are going too far?
10. Is culture priced?
11. What evidence exists regarding the influence of the law, supervisory recommendations, and regulatory guidelines on culture?
12. How can we encourage a culture of partnership at banks when the different divisions that make up the bank act independently of one another, and division employees are loyal to their cohorts?
13. What is the "right" relationship between firms and their regulators?
14. What outcomes in a bank can be affected by culture?
15. Can human resource policies regarding the hiring, promotion, and firing of employees be used to influence culture?
16. Can management oversight and organizational elements change or improve culture?
17. Can oversight functions improve culture? What practices or approaches—by the risk or legal functions, for example—improve culture?