Master Thesis

Institutional Corruption in Finance and Organisational Solutions Against Losing Ascribed Purpose

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I declare in lieu of oath, that I wrote this thesis and performed the associated research myself, using only literature cited in this volume. If text passages from sources are used literally, they are marked as such.

I confirm that this work is original and has not been submitted elsewhere for any examination, nor is it currently under consideration for a thesis elsewhere.

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Place and Date *Signature*

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Kurzfassung

Institutionelle Korruption ist ein Konzept, das entwickelt wurde, um schlecht funktionierende Organisationen aus einer neuen Perspektive zu analysieren. Organisationen können von ihrem Zweck abweichen und ihr öffentliches Vertrauen verlieren, obwohl es keine Anzeichen für individuelle Korruption gibt. Institutionelle Korruption tritt auf, wenn ein rechtlicher, sogar derzeit ethischer Einfluss die Wirksamkeit einer Organisation schwächt und ihr öffentliches Vertrauen schädigt. Letztendlich kann diese Art von Korruption, die Teil der alltäglichen Verfahren einer Institution wird, für die Gesellschaft schädlicher als individuelle Korruption sein. Ziel dieser Arbeit ist es, Erkenntnisse über institutionelle Korruption im europäischen Finanzsektor zu gewinnen. Die Europäische Zentralbank, die Europäische Bankenaufsichtsbehörde, die Deutsche Bank und der Prüfungssektor werden im Rahmen der institutionellen Korruption analysiert. Systemische und strategische Einflüsse, die diese Institutionen betreffen, werden identifiziert, um zu untersuchen, wie sie die Effektivität und das Vertrauen der Institutionen verringern. Darüber hinaus werden Lösungen zur Organisationsgestaltung vorgeschlagen.

Schlüsselwörter: institutionelle Korruption, legale Korruption, Drehtüreffekt, Lobbying, Finanzen, Europa, Europäische Zentralbank, Europäische Bankenaufsichtsbehörde, Wirtschaftsprüfung, Deutsche Bank

Abstract

Institutional corruption is a concept that is developed to analyse malfunctioning organisations from a new perspective. Organisations may divert from their purpose and lose their public trust although there is no sign of individual corruption. Institutional corruption occurs when a legal, even currently ethical influence weakens an organisation's effectiveness and harms its public trust. Eventually, this type of corruption that becomes a part of quotidian proceedings of an institution can be more detrimental for the society than individual corruption. This work aims to gather insights about institutional corruption in the European finance sector. European Central Bank, European Banking Authority, Deutsche Bank, and the auditing sector will be analysed within the scope of institutional corruption. Systemic and strategic influences affecting these institutions will be identified for examining how they decrease the institutions' effectiveness and trust. Moreover, solutions concerning organisational design will be suggested.

Keywords: institutional corruption, legal corruption, revolving door, lobbying, finance, Europe, European Central Bank, European Banking Authority, auditing, Deutsche Bank

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1 Introduction

On the 10th of March 2008, Bear Stearns was operating with a stock price worth $70 a share. On the 17th of March, the company was sold to J.P. Morgan for $2 a share. On the 15th of September Lehmann Brothers filed the biggest bankruptcy in US history and global markets collapsed showing that such a bank is too-big-to-fail. Many other financial institutions were bought by others or saved by the government. After the 2008 global crisis, the trust in financial sector saw a tremendous decrease. Although American institutions were under the spotlight, European financial institutions were far from being innocent. Thirty European banks such as Royal Bank of Scotland or Commerzbank had to be saved through immense sums. Extensive risk-taking accompanied by vicious compensation schemes played a vital role in the downfall of the financial sector. The crisis showed that the financial system was formed by organisations with flawed institutional designs and unfunctional control mechanisms. Private organisations such as banks, rating agencies, auditors, financial consultants as well as public institutions were all part of the problem. Before the Europe could recover from the global crisis, its periphery governments starting with Greece in 2010 were struck by debt emergencies. Also, during this crisis, various financial institutions like Goldman Sachs, large French and German banks, European Central Bank, were involved. The following years resulted in austerity measures for citizens of Greece, Ireland, Portugal, Italy, and Spain. The consequence was the loss of trust in financial institutions as well as governments.

At the most fundamental level, finance is an intersection point between an entity that needs money and another entity that can provide it. This principle is relevant for loans of every scale. A bank can provide a loan for someone to purchase a house or large firms and investors meet each other in stock exchange markets. The initial purpose of finance was altered due to many factors such as deregulations, technological advancements, and high-level competition. Finance was gradually transformed to be an end in itself, producing money out of money while financial markets grew to be multiple times larger than real economies. The initial role of finance should be considered again for a sustainable development and future; “an instrument at the service of economic, trade and human activities, and not an end in itself: to produce money out of money in the shortest possible time” (Baranes, 2009, p. 416). The concept of institutional corruption offers a new perspective for institutions so that they can define and fulfil their purpose.

1.1 Problem Statement

Purpose, vision, mission, and core values are institutions' north star on developing future strategies and organisational pathways. Moreover, they showcase an institution's perspective on different aspects. Although purpose and institutional goals seem to be stable, they can slowly change over time because of continuous compromises. It may come to a point in which organisations lose their effectiveness and cannot fulfil their goals and mission. This situation will doubtlessly result in disappointment of involved stakeholders and these organisations will suffer from the loss of public trust.

In fact, according to organisation theory, organizations are not always rational systems following their desired goals; contrarily, organisations often divert from their purpose (Oliveira, 2014). This erosion of purpose can happen due to different reasons. In case of institutional corruption (IC), the interest lies on legal sources. Various factors can cause institutions to diverge from their goals and core purpose. For instance, campaign donations from private companies may be influential. Trusting a politician's integrity who insists on the deregulation of complex financial instruments which should stimulate economic growth can be challenging if this politician's main campaign supporter is the finance sector (Lessig, 2018). Even if donations may not create an obvious conflict of interest at first sight since this candidate can have a corresponding view on economic matters, they can result in prioritisation. The analysis of the issues that attracted the attention of US Congress during the first quarter of 2011 displays a clear case of prioritisation. During this hectic time, USA was facing a big unemployment problem, country debt was on its highest level, matters about Obamacare and climate change legislation were waiting to be addressed. However, the issue that got ahead of others was bank swipe-fee controversy (Carter & Grim, 2012).

Complaining about corrupted politicians or bankers has always been spoken out by people but what kind of corruption is being faced? The concept of institutional corruption was introduced in 1995 by Thompson (1995) to analyse the problems in US Congress. Thompson, appointed by Derek Bok in 1986, was the founding director of Edmond J. Safra Center for Ethics in the University of Harvard. Lawrence Lessig took over his role in 2009 to advance the research on the topic. He founded Edmond J. Safra Research Lab to concentrate particularly on the phenomenon of institutional corruption (Harvard University, n.d.). Institutional corruption happens when a "legal, even currently ethical influence weakens an organisation's effectiveness and harms its public trust" (Lessig, 2013, p. 553). Ultimately, even people with good intentions may become pieces of a corrupted system as corruption is embedded in regular cycles of an institution. This type of corruption that develops into being a part of quotidian proceedings of an institution can be more detrimental to the society than corruption in its traditional sense.

Institutional corruption is present in many areas. The financial sector is a notable field "as the sector has come under close scrutiny in the past decades for an overemphasis on profit seeking—often portrayed as to the detriment to their customers and society" (Ehrenhard & Fiorito, 2018, p. 1).

1.2 Aim of the Work and Solution Approach

First, this works aims to expand the traditional field of corruption, since the concept of institutional corruption allows a wider focus and accordingly a more robust analysis (Lessig, 2013). The theory of IC is enticing because it enables the extension of corruption theory which solely encompasses the public domain to private sector (O'Brien, 2013a; M. S. Salter, 2010). It equally opens new doors to analyse the corruption in public institutions. Furthermore, social analysts concerned about common good cannot limit their studies only on the public sector but they should consider how private institutions can equally harm public good (Taylor, 2014). Second, the approach to institutional corruption as a problem of organisational design offers a new perspective for organisational theory. IC presents a larger standpoint, bringing different aspects of organisational design together. Third, the financial sector in Europe will be analysed within the framework of institutional corruption and the repertoire of the research in financial domain will be extended with new institutions. IC is now a well-researched concept in USA, as Edmond J. Safra Research Lab was launched to tackle this subject. However, the research is scarce in Europe and the concept is worth contemplating as it sheds light on corruption which is detrimental for the quality of life and our democracy. The gathered insights can be used by firm boards, relevant EU organs, governments, academics, journalists etc. External as well as internal authorities are important since the change can happen internally in organisations or externally through policy changes. Institutional corruption theory can guide external authorities to create appropriate laws. Internal authorities can design their organisations better, ameliorating effectiveness (Oliveira, 2014). The analysed institutions are not identified to blame but to find solutions for improving their effectiveness. Consequently, the final point is generating organisational solution suggestions.

Dennis Thompson, the father of the field, reveals the matter that authorities should address: "look for reforms that change structures and incentives rather than increase punishments and denunciations of individuals" (2013, p. 17). The concept of institutional corruption aims to identify systemic conditions and problems which lead to the loss of organisational purpose. Situations in which organisational members wind up working in corrupt ways without participating in personal corruption should be investigated as it can happen to anyone considering how improper dependencies surround every sector. Along these lines, the concept of institutional corruption aspires to recognise which mechanisms cause rational actions that generate irrational results.

For instance, the 2008 financial crisis cannot be explained by claiming that "somehow, and inexplicably, everyone just became insanely greedy—irrationally borrowing more than they could repay, irrationally lending more than was prudent, irrationally ignoring the warning of impending doom" (Lessig, 2011, p. 67). The actions of bankers and housing agencies considering their incentive systems, the will of borrowers to own a house in the pursuit of American dream or the reactions of politicians may appear rational if observed separately. Yet, the consequences: many citizens losing their houses, non-punished corporate executives and a collapsed economy are irrational. Thus, for the analysis of problematic mechanisms, purpose and goals of institutions will be found, factors influencing the fulfilment of the purpose and goals will be identified and examined. Afterwards, solutions for specific problems will be suggested so that institutions can work in the direction of their purpose.

1.3 Methodology

The concept of institutional corruption was designed by Dennis Thompson and Lawrence Lessig to analyse functional problems of US Congress. As this approach opened new doors to examine institutional problems in Congress, researchers applied it in other fields. The concept proved itself to be applicable within a large spectrum of organisations and was even used to show dysfunctions in entire sectors. However, the first working papers and cases were presented without a methodology, creating doubts about the concept's adaptation accuracy to other fields. An effort for conceptualisation was required to enable the usage of the concept outside of its original field of politics. Oliveira (2014) approached the concept of IC as a problem of institutional design. In this work, Oliveira's methodology will be complemented by important elements from Lessig's definition of institutional corruption to ensure a holistic approach. The identification of strategic and systemic influences and their effects will be used to spot institutional design problems. The following step-by-step methodology will be utilised to analyse the selected institutions:

(1) Designation of the organisation/industry that will be studied within the framework of institutional corruption
(2) Identification of the institution's foundation: purpose/mission/vision and granular goals given by laws, the institution itself or externally determined by industry/society
(3) Analysis of the institutional design and identification of strategic and systemic influences
(4) Institutional corruption exists if:
   - Institutional design problems such as business model, financing, governance, incentive, and communication structures block achievement of the purpose or obstruct attainment of granular goals
   - Granular goals are not well-suited to achieve the purpose

(5) Solution suggestions for identified problems

The first point, designation of the organisation/industry is self-evident. The chosen organisation can be a public institution like a state hospital or a private company like Salter (2010) examines the case of Enron. Furthermore, entire sectors or industries can be selected, for example Marc Rodwin (2013) analyses IC in pharmaceutical industry and Youngdahl (2013) IC in investment consultancy domain.

Identification of the organisational purpose and goals is an important element, since their achievement will show if institutional corruption exists. The purpose can be identified through various methods. A vital source is the laws. For instance, the purposes of public institutions like European Central Bank (ECB) and European Banking Authority (EBA) are given in their regulations written by European Union. The goals can equally be taken from regulations, but they are also presented in the websites of institutions. For the analysed sector of auditing, a mission is equally presented in the relevant regulation. On company level the purpose is usually provided through vision and mission statements of the organisation as well as its core values. They can be found in their annual statements along with company goals. Moreover, the analyst can work with the purpose on industry and societal level to identify institutional corruption. This approach is more suitable for industry sectors such as politics, medicine or pharmacy as the purpose on these levels is simpler to establish; the purpose of medical and pharmaceutical sector is “ameliorating health of the people”, the purpose of Congress is “working for the people”. On the other hand, societal purpose of a bank has a higher potential of subjectivity.

Analysis of the institutional design is necessary to find organisational blind spots. Problems in business model, governance structures, compensation methods, financing or communication can pave the way for institutional corruption. Consequently, the analyst must grasp the details of institutional design. Moreover, effects of systemic and strategic influences will be difficult to analyse if relevant institutional structures are not known. The systemic and strategic influences are gathered through literature research. Furthermore, the knowledge of institutional design details is necessary to generate solution suggestions.

Institutional corruption exists if institutional design problems such as business model, financing, governance, incentive, and communication structures block achievement of the purpose or obstruct attainment of granular goals. In some cases, it is possible to directly identify if the purpose is not achieved. In some other cases, the direct analysis concerning the attainment of the purpose is more difficult. For that reason, the fulfilment of goals is analysed. The central purpose should be deconstructed to granular goals to be effectively executed. If important goals are not attained, it can be assumed that an institution has difficulties to achieve its purpose. Furthermore, there is also the option of granular goals being not well-suited to achieve the overarching mission.

Oliveira (2014) explains this situation by problems in work breakdown structure; it is not possible to attain the overarching mission with existing granular goals. Moreover, according to Oliveira, inadequate structures of incentives and communication can cause institutional corruption. For example, banks' excessive risk-taking was one of the main causes of the 2008 crisis and their compensation structure played a vital role on extreme risk-taking (Bebchuk & Spamann, 2009). Furthermore, there are many other organisational mechanisms that can deviate an organisation from its purpose. For instance, problematic business models can result in institutional corruption. Such mechanisms are visible in the financing structures of rating agencies and auditing firms. They may lose their independence due to their business model, in which they give "operating licenses" to their clients. The role of rating agencies during the 2008 crisis was a highly discussed subject (Lessig, 2018). Also, how some auditing companies willingly made mediocre financial analyses on audited firms or even helped firms to appear healthier than they were, is now a known fact. The scandal caused by Enron and its auditing partner Arthur Andersen and their subsequent collapses are still shaping the view of experts (M. S. Salter, 2010). Occasionally, it is difficult to analyse organisational influence mechanisms within Oliveira's framework of work breakdown structure. For instance, the literature research shows that governance problems in European Banking Authority cause serious dependence issues that affect the effectiveness of the institution. In a way, such an influence can be formulated as a granular goal, but it is easier to analyse it as a governance problem. Therefore, Oliveira's methodology is extended through additional elements of institutional design such as business model, financing, recruiting/appointment, and governance.

The next step of the analysis is the generation of solution suggestions. Remedies for identified problems concerning institutional design problems will be developed. These remedies can be generated internally in institutions or by public authorities through laws. To exemplify, literature research and the analysis of institutions like ECB and EBA indicate that the phenomenon of revolving door which consists of public-private sector employee exchange, is a mechanism that is utilised to influence public organisations. Revolving door can be dealt internally through institutional mechanisms of appointment but also through adequate cooling-off periods implemented by EU law. Furthermore, in some cases, important remedies are already implemented. For instance, the laws concerning auditing firms' services were recently adjusted to enhance auditor independence under the Regulation 537/2014. Thus, the most important elements of this regulation will be contemplated.

Using this methodology, a qualitative and interpretive research will be conducted to analyse systemic dysfunctions in organisations. Qualitative, interpretive methods have long been an important part of organisational research (Kenny, 2014).

1.4 Research Design

The research is planned in five chapters.

The first chapter, as its name suggests introduces the concept of institutional corruption. The introduction starts with a motivation, then the problem is stated with its central points. This statement serves as a starting point as well as conveying the importance of the concept, as organisational and societal consequences of institutional corruption are presented. Subsequently, the solution approach, the aim of the work and the methodology are given. Research design reveals the structure of the work.

Fundamentals of institutional corruption are presented in the second chapter. First, the traditional understanding of corruption is illustrated. Then, the path to institutional corruption is examined while browsing similar concepts such as legal corruption or rich-country corruption. Especially, the phenomena of lobbying and revolving door are presented in detail. They are legal practices, but their misuse can pave the way for institutional corruption. Second, definitions are given to establish an ideal fundament for the research and avoid possible ambiguities. Beside the given definitions this part also highlights the origin of the concept through first written works. Subsequently, all the important elements in the definition of institutional corruption are analysed in detail. These elements are systemic and strategic influence, institutional purpose, deviation from purpose, and loss of effectiveness and public trust.

In chapter three a literature review on institutional corruption in the finance sector is offered. The reviewed organisations are categorised under public institutions and private sector. While the research on public financial institution is scarce, there are many cases in private sector. The analysed organisations within the framework of institutional corruption are grouped under financial consultants, tax professionals, rating agencies, and banks.

The studied institutions are presented in the fourth chapter: European Central Bank, European Banking Authority, the auditing sector, and Deutsche Bank. All the case studies have the same subcategories of mission and goals, institutional design, analysis within the scope of institutional corruption and solution suggestions. After identification of institutions’ purposes and goals, institutional designs are scrutinised in detail. Next, the institutions are analysed within the scope of institutional corruption and organisational solutions are suggested.

Finally, the topic is resumed with a discussion of found results. Afterwards, limitations of the work as well as future research directions are given.

2 Fundamentals of Institutional Corruption

2.1 Traditional Understanding of Corruption

In its traditional sense, corruption is defined as "misuse of public office for private gain. Corruption that is defined this way would capture, for example, the sale of government property by government officials, kickbacks in public procurement, bribery and embezzlement of government funds" (Svensson, 2005, p. 20). Corruption has direct and negative effects on economic growth, while democracy has indirect effects providing political stability and enabling people to change governments which misused their power (Drury et al., 2006).

The characteristics of corrupt countries are, a low-income level, governed or recently governed by socialist governments and a closed economy. The later characteristic explains the elevated level of corruption in countries with relatively higher income like Russia, Venezuela, and Argentina. In general, regulations lead to corruption as rent seeking is prevalent (Svensson, 2005). Rent seeking is very costly for growth because it decreases productive activities, especially innovative activities (K. M. Murphy et al., 1993). Rent seeking is displayed in every kind of governing system; in democracies through lobbying for special subsidies, trade protections, tax loopholes or competition barriers (English, 2013).

80 years ago, Edwin Sutherland (1940) expanded the field of corruption with his paper "*White-collar criminality*", in which he rejected the simple-minded perception that the crime is merely linked to poverty. In those years, the crime database contained mostly the crimes from lower-class citizens forming a biased sample. After further research, Sutherland documented the criminal activities of USA's biggest private companies, revolutionizing the criminology literature. After Sutherland's expansion of corruption from poor people to citizens with higher income, it is time to consider the phenomenon in country level. The fact that corruption is usually associated with poor and developing countries raises many questions about the situation in high income countries; is corruption non-existent in high income countries? How does it occur? Is it only a problem for public institutions? Is it always illegal?

2.2 The Path to Institutional Corruption

Similar to institutional corruption, unconventional forms of corruption were analysed under different names such as legal corruption (Kaufmann & Vicente, 2011; Dincer & Johnston, 2015; Maciel & de Sousa, 2018) and rich country corruption (Graycar & Monaghan, 2015).

Many surveys present that people living in high-income countries perceive corruption in their country although they have almost no personal experience of victimisation. Graycar and Monaghan (2015) suggest a method called TASP (type, activity, sector, place) to identify corruption. They include conflict of interest, abuse of discretion, patronage, nepotism, cronyism, and trading in influence in their model of corruption. They particularly highlight lobbying and the concept of gaming introduced by one of the Edmond J. Safra researchers, Malcolm Salter (2010). There are also other attempts to use corruption as an umbrella concept for occurrences of clientelism, patronage, patrimonialism and state capture (Varraich, 2014). Kaufmann and Vicente (2011) analyses the phenomenon they call *legal corruption* with a mathematical model as well as empirical analysis concentrating at corruption induced by private sector. They find that the concepts of legal and illegal corruption are very similar but then rich countries are challenged by legal corruption. Another important finding is that accountability is vital to fight legal corruption. Furthermore, a quantitative study mapping legal and illegal corruption in US American states was constructed by two fellows from Edmond J. Safra Research Lab, Dincer and Johnston. They define illegal and legal corruption as: "illegal corruption as the private gains in the form of cash or gifts by a government official, in exchange for providing specific benefits to private individuals or groups, and legal corruption as the political gains in the form of campaign contributions or endorsements by a government official, in exchange for providing specific benefits to private individuals or groups, be it by explicit or implicit understanding" (Dincer & Johnston, 2015, p. 3). The data from *Edmond J. Safra Center for Ethics Corruption in America Survey* was used to identify legal and illegal corruption in executive, legislative, and judicial areas. The study sketches how legal and illegal corruption can have different rates in a same state.

In the European background, Maciel and de Sousa (2018) published "*Legal Corruption and Dissatisfaction with Democracy in the European Union"* to analyse the rising discontent for democracy from an institutional perspective. Formerly, dissatisfaction with democracy was mainly explained by poor economic performance as people notice no improvement of their standard of life. A relatively newer perspective to explain this distrust is the dissatisfaction with institutions. Nevertheless, no consistent pattern was identified for corruption as an explanation to this problem. The reason for this is the strict definition of corruption, only encompassing illegal occurrences, which infrequently happen in the European Union. Three questions from survey data of European Commission were used to identify legal corruption (Maciel & de Sousa, 2018, p. 662):

(1) "Talking more generally, if you wanted to get something from the public administration or public services, to what extent do you think it is acceptable to do a favour?

(2) Please tell me whether you agree or disagree with… there is sufficient transparency and supervision of the financing of political parties in your country.
(3) Please tell me whether you agree or disagree with… In your country, the only way to succeed in business is to have political connections".

One question was asked to detect illegal corruption: "Do you personally know anyone who takes or has taken bribes?" The empirical results show that, illegal corruption is not significant for trust in democracy while legal corruption has a significant effect in the European context.

It is in fact surprising that such studies concentrating on different forms of corruption are relatively new. It is also time that academics and policymakers focus on this underhanded type of corruption. Phenomena such as third-party campaign donations, informal lobbying, practices of revolving door need particular attention.

2.2.1 Lobbying

In an attempt to discover a relationship between lobbying and corruption, the data from 4000 firms in 25 transition countries were analysed by Campos and Giovannoni (2007). The authors found that corruption and lobbying were substitutes. Lobbying was preferred in countries with relatively higher gross-domestic product (GDP) like Hungary or Slovenia instead of bribing, common in countries such as Moldova or Bosnia. Moreover, they noticed that even in relatively poorer countries lobbying is a more effective tool of influence than illegal corruption. Harstad and Svensson (2011) equally found out with a growth model that bribe switches to lobbying according to development level. The crucial problem with bribing is that it leads companies to a hesitancy of investment due to high unpredictability of the future. For instance, a bribed person may lose its job and the new officer may not accept bribes. Consequently, companies will not pursue long-term investments to grow, resulting in a vicious cycle of bribing and poverty.

Beside the legality aspect, the main differences between bribing and lobbying are: (1) In case of lobbying, a change affects all the companies in a domain, including future entrants, while a single company profits from a bride. (2) The change is more permanent if a law is changed through lobbying. The provided stability encourages companies for investments. (3) Government members compare the income earned by lobbying to administrative and public costs of rule changing. On the other hand, acceptance of bribe causes an individual benefit. (4) Lobbying is usually done by multiple firms or as a whole sector with the help of lobbying firms or joint associations (Svensson, 2005).

A deeper understanding of lobbying and its impact is vital to comprehend how external influences mark institutions. Lobbying is a constitutional right and certainly, some

organisations can have legitimate reasons to oppose old or new laws. Their reasons may also be beneficial for the public (M. S. Salter, 2010). Moreover, lobbying is important to provide expertise from different actors while making complex policy decisions. Lobbying is unfair when transparency and ethical concerns are not respected (Dialer & Richter, 2019). Private organisations as well as public institutions should assure that public welfare is considered. It is especially problematic and damaging for public trust when firms give open support to policies that they covertly lobby against.

Lobbying saw a tremendous rise in 21st century. In USA, between 2000 and 2010 the lobbying spending grew over 100%, from $1.6 billion to $3.3 billion. Even after adjusting the inflation, an increase of 64% can be observed. It is important to know that this sum only includes the remuneration of lobbyists, excluding publicity and campaign donations (Draca, 2014). In Europe, 1.7 billion euros were devoted to influence EU decisions in 2016. Interestingly, 95% of this sum was paid by high income western countries which joined EU before 2005 (Dialer & Richter, 2019).

Financial lobby has always been one of the biggest money spenders. For example, financial industry used more than 3000 lobbyists and spend more than $57 million on donations to adjust Dodd-Frank reform bill (M. S. Salter, 2010). In Europe, German lobbyists endorsed by Austrian and Italian groups succeeded to change the Basel III agreement on capital requirements of banks for lending to small to medium-sized enterprises (SMEs). The banks claimed that the new capital requirements would endanger credit possibilities for SMEs, but this assertion not proved in calculations of Bundesbank. After unsuccessful attempts of convincing financial authorities, lobbies directed their attention to media sources like AG Mittelstand to influences SME owners and politicians. Ultimately, the German national government as well as European Parliament sided with banks against regulators. The matter became even a priority during Trilogue Negotiations in EU Parliament with the outspoken arguments of Austrian parliamentarian Othmar Karas (Keller, 2018). In the empirical research of Mc Leay and al. (2000) the effects of lobbying activities on German accounting regulators are documented. The research was done to identify the impact of auditors, academics, and industry members. They found out that industry succeeded with 63%, while 73 of their 111 proposals were accepted. On the other hand, the success rate of academics was 38% with 32 accepted proposals out of 83. It should also be noted that the recognition chance of industry propositions were three times superior when their request was supported by academics or auditors.

Although lobbying actions are known, a total understanding of lobbyists' proceedings on influencing reforms in a framework of legality is unexplored. Works offering insider information on lobbying like Gray's paper (2013) on Jack Abramoff become very vital to battle extensive rent seeking paving the way for institutional corruption.

2.2.2 Revolving Door

OECD defines the process of the revolving as “the movement of people into and out of key policymaking posts in the executive and legislative branches and regulatory agencies” (Dinan & Miller, 2009, p. 8). The phenomenon of revolving door is regarded to be harmful for society. It was considered as one of the elements of 2008 financial crisis along with following occurrences involving bailout dealings. In French, it is referred as *pantouflage* meaning getting comfortable, like during putting on slippers and *amakudori* in Japanese meaning descent from heaven (Brezis, 2017).

Mirko Draca (2014) made an investigative research using databases of employment for governmental personnel and the reports of the Lobbying Disclosure Act (LDA) to analyse the effect of revolving door in Washington. He could then identify the number of employees who became subsequently lobbyists and gather information about their salaries. Examining the LDA reports, it could be seen that 42% of lobbyists had governmental experience, half of them congressional occupation. Every third Chief of Staff took a job in a lobby firm. The salaries of governmental officers who became lobbyists augmented three to eight times depending on the position. Furthermore, the existence of a market for congressional access was contemplated. It was observed that loss of a connection to a senator resulted in a 23% decrease in the salaries.

Presence of former governmental workers in lobbying firms may decrease the effectiveness of relevant institutions. Former lobbyist Jack Abramoff illustrates a clear example of this situation; the former Chief of Staff, Neil Volz of the Senator Bob Ney started working for Abramoff’s firm after a revolving door process. Volz convinced Ney to insert a “corrupt rider” in a reform bill for the benefit of a casino owner. In USA, amendments that do not fit within the scope of the contextual purpose of a reform bill can still be included in bills, presenting opportunities to insert policies wanted by lobbyists and their clients, in that case, a casino license (G. C. Gray, 2013). Brezis (2017) shows with a mathematical model that although the phenomenon of revolving door is lawful, it creates economic distortions. The bureaucratic capital gained by revolving door causes a suboptimal economic growth. The phenomenon also creates inequalities between firms as biggest firms such as Goldman Sachs and Citigroup can afford to hire former government employees, for instance Goldman Sachs employs 30% of revolving door members in finance sector (Brezis & Cariolle, 2019).

Literature on European lobbying shows that direct access to legislators is a more effective method than reports and media strategies. Nevertheless, usually a mixture of both approaches is used. Privileged access to decision-makers is vital for firms and the financial sector is one of the most prominent users of revolving door to secure this access (Dialer & Richter, 2019). Nonetheless, although the phenomenon was in rise

in German context since 1980s, the practice is less common than in the USA. Still, a prominent position in a private firm is the second most popular post-cabinet career option (Dörrenbächer, 2016). The author equally found out that public officials who had a degree in business and worked in a department with more lobby contact were more likely to continue in private sector. The ministries with highest percentage of revolving door were respectively economics, foreign affairs, and finance. Moreover, the chance of switching to private sector was the highest in the following year after quitting public office.

A well-paid job in private sector is presented to public officials causing concerns that ethical standards are breached when ex-public workers have jobs, in which they lobby their former colleagues or even worse, that this might be the result of previously favourable regulations. “Revolvers” are also valuable for corporate firms as they have inside knowledge of possible loopholes and proceedings (Brezis & Cariolle, 2019). If the transfer is the other way around, public is worried that the governmental regulations will favour corporate benefits. The OECD (2009) report shows the prominent revolving door members in regulatory agencies in Europe in countries such as UK, Belgium, Iceland, Ireland as well as other OECD nations around the world. Banks that have multiple revolving door members like Barclays, HSBC or Deutsche Bank are also revealed. In recent years, many revolving door cases occurred in EU Commission and EU Parliament. Silva (2019) documents most recent cases in these institutions. The practices of prominent former commissioners such as José Manuel Barroso, Karel de Gucht and Neelie Kroes are recorded. Subsequently, the code of conduct was revised in January 2018 supplanting the previous one from April 2011. The cooling-off period for former commissioners was increased from 1,5 years to 2 years and to 3 years for the President of Commission. Revolving door is equally noticeable in EU Parliament even though MEPs have a transitional payment guarantee. After leaving their positions, they are entitled one month’s salary for every year they were in office as MEP.

Financial sector particularly profits from a belief system and a closed network of professionals in important positions. The sector flourished from 1980s until the global crisis through extensive deregulations because many government officials truly believed that free-flowing capital and big financial actors were crucial for economic welfare (Johnson & Kwak, 2011). The intimate relationship between Wall Street and Washington facilitated the growth of finance industry and the industry increased its political power through cultural capital. This belief system, combined with political donations and private connections, obstructed the separation between commercial and investment banking and paved the way for an international deal allowing banks to rate their own risk (M. S. Salter, 2010).

To sum up, majority of the literature establish that revolving door practices have harming effects for society because of asymmetric affordability and use, reliance on connection instead of expertise, special benefits and direct effects of hiring on firms' financial situation (Zinnbauer, 2015). Furthermore, in many EU countries such as Austria, Belgium, Sweden etc., safeguards against revolving door practices do not exist at all. On the other hand, some other countries enforce long cooling-off periods; for instance, 5 years in Canada (Silva, 2019). Zinnbauer (2015) proposes usage of social media platforms like LinkedIn to perform empirical studies on revolving door.

2.3 What is Institutional Corruption?

The concept of institutional corruption was presented by Dennis Thompson (1995) to supplement the traditional literature of corruption. In his book, "*Ethics in Congress: from individual to institutional corruption*", the notion of IC was introduced as an answer for enduring problems faced in politics. Since the Congress as an institution gradually lost its public trust, it was necessary to observe the phenomenon of corruption through a different lens. Traditional means of corruption like bribes or expensive presents which are not accepted by many politicians or the breach of political ethics could not explain such an overall decline of trust. The presence of systemic problems obstructed the Congress' pursuit of its mission: "serving the citizens". A different kind of corruption happened in the Congress, a corruption that is embedded in the routines and procedures of the organisation: institutional corruption.

Thompson contends that the concepts of individual and institutional corruption should be defined clearly to be combatted effectively:

Individual corruption according to Thompson:

"Individual corruption occurs when an institution or its officials receive a benefit that does not serve the institution and provides a service through relationships external to the institution under conditions that reveal a quid pro quo motive" (Thompson, 2013, p. 3).

Institutional corruption according to Thompson:

"Institutional corruption occurs when an institution or its officials receive a benefit that is directly useful to performing an institutional purpose, and systematically provides a service to the benefactor under conditions that tend to undermine procedures that support the primary purposes of the institution" (Thompson, 2013, p. 3).

In these definitions, it is possible to observe that a benefit like a campaign donation is necessary to run as a congressional candidate and useful to perform institutional

purpose but can cause prioritisation for donors' issues and possible conflicts of interest when a candidate votes for policies related to involved donors. Consequently, the effectiveness of politicians and the Congress as a whole is damaged since corporate campaign donations are accepted by many elected representatives and senators. The decreased subjectivity for issues may hinder the Congress' fulfilment of its primary purposes. Even the fact that an agent acts in a context of an improper influence creates the necessary ground for institutional corruption, regardless of the agent's intentions.

Lawrence Lessig noticed that the dependence of Congress on private donations was the primary factor endangering the democracy. The Congress was not dependant on the people *alone* but equally dependant on its funders. He concentrated on this phenomenon and later advanced the concept of institutional corruption in new fields. Lessig's research on this field was pursued because he expressed that the black and white view of ethics should be extended to explain how institutions employing "good" people could harm democracy, public health, and wealth. Edmond J. Safra Research Lab, which is launched by Lessig in 2012, focused on the practical examples of institutional corruption by publishing multiple working papers on the subject. Lessig's definition additionally highlights the loss of effectiveness and public trust. The definition extends the Thompson's one without contradicting it.

Institutional corruption according to Lessig:

"Institutional corruption is manifest when there is a systemic and strategic influence which is legal, or even currently ethical, that undermines the institution's effectiveness by diverting it from its purpose or weakening its ability to achieve its purpose, including, to the extent relevant to its purpose, weakening either the public's trust in that institution or the institution's inherent trustworthiness" (Lessig, 2013, p. 553).

The definition is institution-agnostic, thus it can be adapted to any institution such as the Church or the Mafia. Furthermore, there is no overall judgement: an influence that corrupts an institution should not always be stopped because the advantages of such an influence can overweigh its drawbacks or the benefits overweigh the cost of reforming the institutional design.

This concept is also referred as Thompson-Lessig-Model. In this work this definition of institutional corruption will be used and in next sub-chapters, its important elements will be analysed in detail.

2.3.1 Systemic and Strategic Influence

Systemic or strategic influences, implicitly or purposely distort the independence of a trusted institution. (Gray, 2013). These influences can be external as well as internal; an outside funder contesting for own purposes stipulates an external influence, on the

other hand, internal influences can be incentive systems or a manager's instructions (M. S. Salter, 2010). While Thompson's concept concentrated on systemic influences within the Congress, Lessig focused on the Congress' dependency on campaign donations and how they affected politicians' choices. The framers of House of Representatives outlined the clear dependency that should occur; the Congress must be "dependent on the people alone" (Lessig, 2018, p. 15). Contrary to this framework, Congress became not only dependent on the people but also on its funders. This improper dependency resulted in influence on legislative procedures by the biggest funders, mainly big corporate firms. In 2014, 100 biggest campaign donors provided $323 million and $356 million was given by 4,75 million small donors who spent $200 dollars or less (Vogel, 2014). In fact, Lawrence Lessig himself ran for president for the 2016 elections after a crowd-sourced campaign. His main promise was a reform on campaign funding. His campaign ended in 2015 after he argued that the Democratic Party hindered his appearance in television debates due to changed rules (Graham, 2016). Moreover, important democratic candidates such as Elisabeth Warren and Bernie Sanders refused corporate donations for 2020 elections. Warren, Sanders and Biden all promised a campaign funding reform although their plans differ in some points in order to "get the big money out of politics" (Evers-Hillstrom & Yu, 2019). Additional to campaign donations, the influences given by Thompson (2013) were endorsements, organisational support and media exposure. Lessig cites that, influences can come in different schemes but the most common one is money. Lack of money can cause different reactions. It can result in fear and detrimental policies as financial resources are necessary for institutions' survival. Moreover, the phenomenon of revolving door and prominent career offers should be considered as an important influence.

One of the crucial points in the theory of IC is the nature of the influence; it is legal and can be even ethical. The status of legality is an on-going process. Which is legal today, can be illegal tomorrow or vice versa. Ethics is a complex field incorporating high levels of subjectivity. In order to get an insider account on institutional corruption, former lobbyist Jack Abramoff was interviewed by Lawrence Lessig in Edmond J. Safra Center for Ethics. His confession highlights the dependency of Congress on legal campaign donations: "We know a bribe is when you show up with a stack of cash and say, 'Here's $10,000 in cash, and can you do this for me?' But if I show up with 10 × $1,000 campaign contributions and say the same thing, that's not a bribe in Washington. Outside of Washington, everybody gets this… but inside Washington, that's the way it's done…. We have institutionalized corruption in Washington. It's perfectly accepted, and it's acceptable to virtually everybody, and that's where things need to change" (G. C. Gray, 2013, p. 534).

Another important point about influences is the fact that they can affect institutional members through biases. Influences may not operate on conscious level and anyone can make unintentionally altered decisions. They are the result of years long evolution

process and very difficult to control, even notice. Sah and Fuh-Berman (2013) documented how different biases created by improper dependencies can influence physicians decision making. These biases are 1) the belief in biased information, 2) the belief in self-bias, 3) the cognitive dissonance bias, 4) the entitlement bias, 5) the reciprocity bias, 6) the consistency and commitment bias, 7) the social validation bias, 8) the friendliness bias and 9) the authority and scarcity bias. Again, the lobbyist Abramoff reveals his experience about biases in politics: "even if they think, 'I'm taking the campaign contribution, I'm going to take that $2,000 but I don't sell my vote for 2,000' they're wrong …. Not consciously but they are human beings. And if somebody does something for you and you are a decent person what is the thing you are going to think in your mind … 'Well gee I can't give them that but I'm going to root for them.' Or 'I can't do that but maybe I can do this.' That is how it starts" (G. C. Gray, 2013, p. 546). The New York Times bestseller "*Thinking Fast and Slow"* (2012) by Nobel laureate Daniel Kahneman equally showcases multiple empirical studies proving the susceptibility of human being to biases. Ethical devotion and professionalism cannot always protect humans from making altered decisions. Thus, the presence and degree of influences on institutions should be as low as possible. A notable solution to achieve this effect is blinding. For instance, prominent universities gather financial donations through their presidents, while researchers do not know names of money funders (Lessig, 2018).

2.3.2 Institutional Purpose

Institutional purpose plays a central role to identify IC. The quote "by diverting it from its purpose or weakening its ability to achieve its purpose, including, to the extent relevant to its purpose" provides two aspects how the purpose can be affected. Beside preventing to achieve the institutional purpose, a systemic or strategic influence can equally put obstacles on the path, complicating the attainment of the desired purpose. This type of effect is also sufficient for institutional corruption to occur.

Lessig (2013) states that an institution must not always have a purpose and evidently cannot be corrupted if it does not possess a purpose. Imagining a purposeless institution is very challenging. Even if an organisation is not explicit about its purpose, a purpose can be attributed by the society. Furthermore, constitutions of respective countries or cross-border regulations also allocate purpose to institutions operating within their laws. The real difficulty lies on identifying that purpose. Clearly, identification of the purpose serves as the baseline for detection of institutional corruption.

In his institutional design-based theory, Oliveira (2014, p. 7) claims that to identify the purpose of an organisation, one should "find the reasons for its creation or for supporting its existence". Two methods of purpose identification are mentioned:

reason-based and rationalisation-based. Reason-based approach uses historical data to identify a purpose. For a firm, that would be reasons establishing why its founders formed it and why its stakeholders are holding it. Even if the purpose changes through time, new purposes can equally be found by analysing evidence-supported data, for example using the data from company's website or information given by founders, managers, stakeholders. On the other hand, during the process of rationalisation a "legitimate" purpose can be attributed to an organisation; like a private hospital's purpose of fostering for customers' health and not just making money. The purpose is attributed by the society and the industry in that case. Oliveira (2014, p. 10) concludes that "the theory of institutional corruption as being agnostic not only regarding the specific purposes of institutions, but also regarding the methods utilized by analysts to find or set the purpose of institutions under analysis." A problem concerning the identification of an evidence-based purpose is that the purpose is rarely given directly. If the website of a firm is studied in order to identify a purpose, the analyst will find company values, mission and vision, subsequently must interpret these findings and decide for a broad purpose. As it can be observed, reason-based as well as rationalisation-based approaches may depend on the analyst's interpretation.

For Newhouse (2013) this subjectivity was a big problem transforming institutional corruption into a vague concept. She asserted that a fiduciary theory is best suited for the concept as in this theory the purpose is obligatory. In the framework of a fiduciary duty the agent must act on the principal's interest, valid for lawyers and their clients or guardians and their wards. This is also the case in Congress since elected politicians are agents who must use their legislative authority on behalf of their voters. Newhouse asserted that organisations that do not have a fiduciary nature should not be analysed within the framework of institutional corruption. This theory puts many private firms out of consideration as they do not fit in. She classified some previously analysed cases of IC under categories of Frauds (unfair commercial practices), Fiends (destructive firm behaviour) and Fools (mistake, inefficiency, incompetence) excluding them from the concept of IC. Taylor (2014), being against the reductionism of fiduciary theory proposed that the expression "purpose" should be understood as "function". Thus, he focused on social functions insisting that the organisations excluded by Newhouse should be indeed part of the institutional corruption theory as they all have functions, especially given by society and laws.

For individual corruption, there are clear rules to identify the deviation; these rules are defined by law. The formula for IC is defined by the analyst. This situation requires a wide-reaching research and analysis of sources to identify IC. Moreover, if the research does not stand on a strong foundation, the work can be confronted. It should not be forgotten that even an obvious purpose given by the society can be problematic in some exceptional cases. For instance, an institution that performs beauty surgeries may jeopardize physical health of customers. The same condition can apply to a

pharmaceutical company marketing weight loss pills. Surely, a beauty operation or a weight loss can improve mental health of customers, but the possible dangers related to physical health consequences create a tricky situation considering the purpose of medical institutions.

O'Brien (2013b) stresses the necessity of separation between the purpose and the end. For example, the end for a doctor is the healing of a patient, but if the purpose is financial gains, stakeholders can be exploited. Unnecessary practices or medicaments can be added to the procedure on the cost of the patient, insurance, or taxpayers. Although the desired end of healing the patient is reached, the situation is still non-optimal. In this case, a supplier-induced demand can be mentioned. If the customer do not have technical domain expertise, supplier can unmorally use that situation (Auster & Oaxaca, 1981).

Another challenge is number of purposes as well as number of stakeholders. Many organisations have multiple purposes and an influence can help to achieve one while preventing to attain another. Also, whose purpose should be considered: owners', managers', employees', or society's? Newhouse (2013) argues that even a very simple activity done by one person can have many purposes. She gives the example of a mother selling Christmas trees. She can have several purposes: selling trees, making money, feeding her children. Other purposes that she did not mention can be for example, giving people Christmas joy or getting in contact with other people. What happens if another businessperson offers her a good deal for baking Christmas cookies and hand them later over? The purposes of selling trees and getting in contact with other people cannot be achieved but making money, feeding her children, and giving people Christmas joy (if the cookies are tasty) will remain. Is there then a case of institutional corruption in that situation? Prioritisation of purposes can be a solution, but the prioritisation process might be very challenging for the analyst as important insider information will be missing. Number of stakeholders is equally complicating the situation as one stakeholder might think that a purpose is fulfilled while another thinks that a deviation exists. Although, all stakeholders agreed on the purpose of the institution during the founding, it is possible that one or more stakeholders have hidden their goals and later act on steering the institution in the direction of their objectives.

An important point here is the communication of the purpose. The previously mentioned institutions performing beauty surgeries or producing weight loss pills should properly communicate the outcomes of used products or services. Patients can then knowingly make decisions, accepting the consequences. Communication is also crucial if the purpose of the institution will be changed. For instance, an institution can change its mission or business model as a strategic decision due to megatrends. An intentional deviation of the purpose must be shared with all the relevant stakeholders including the public or it is a genuine case of institutional corruption.

Overall, the issues concerning the identification of the purpose are:

- Which are the used criteria to identify a purpose?
- How to identify a weighted purpose in case of multiple purposes?
- What to do if purposes are in conflict between each other?
- Which stakeholder's purpose should be pursued?
- How to establish the difference between a purpose change and a deviation?

The same situation and problems also apply for institutional goals. Their identification, and especially multiplicity cause challenges. Lessig wrote "*America, Compromised*" in 2018, documenting the research that is done in the Edmond J. Safra Research Lab, some years after the publishing of papers of Newhouse (2013), Oliveira (2014) and Taylor (2014). Still, the issues of purpose identification are present as he expresses: "What is the value of the concept of institutional corruption, if it can't revolve whether the banks, leading up to the crisis of 2008, were institutionally corrupt or not?" (Lessig, 2018, pp. 51–52)

2.3.3 Deviation from the Purpose

As previously mentioned, the purpose can have different levels of deviation. Total deviation, a situation in which it is not possible to attain the desired end or deviations which obstruct achievement of the purpose due to influences placing barriers on its way. Consequently, the effectiveness is lost, and the purpose is compromised.

Lessig (2011) identifies deviation in input as well as in output. For the case of Congress, input represents the proportion of time spent for private objectives instead of public objectives. In fact, the time spent by Congress politicians to secure funding varies between 30% and 70% (Lessig, 2018). The more time is consumed for funding activities, the less time is left to execute other tasks. In an analysis based on inputs, materials can equally be considered. For instance, the usage of palm oil by a firm representing itself as a sensitive institution to environmental issues is a sign of duplicity. The output for the Congress represents the percentage of legislative outcomes that benefits private parties instead of the public.

Oliveira (2014) suggests that purpose is expressed through specific objectives and goals. This translation is necessary as it is difficult for members of an institution to work for a broad purpose. Specific goals are then expressed in work breakdown structure. Realisation of the purpose is only possible through achieving specific goals and spotting deviation of these goals is easier than identifying the deviation of broad purpose. If an institution cannot fulfil its important goals, how can it achieve its mission? Moreover, this approach is facilitating solution generation since correcting the deviated objectives is simpler than finding a very broad solution for an undesired purpose. For instance, in 2008 crisis, we witnessed that banks deviated from their purpose of

protecting the financial resources of their shareholders as well as the public since their bailout was paid by public taxes. This failing had many reasons but Kenny (2014) found out that the compliances objectives of a great number of banks were not fulfilled. In that case, finding specific solutions to this specific goal of not reaching compliance objectives is easier. The analyst observes achievement of granular objectives to conclude a deviation from the purpose through a process of synthesis.

2.3.4 Loss of Effectiveness and Public Trust

Deviation from the goals and objectives, consequently from ascribed purpose causes loss of effectiveness and public trust. In general, ineffectiveness can be the result of a bad performance or bad design. Institutional corruption happens when the organisational design is flawed. If the design is flawed, even excellent performances from institutional members cannot prevent failure of purpose achievement (Oliveira, 2014). Design problems preventing members to work for the desired purposes lead to IC. Such design flaws may exist in work breakdown structure, incentives, communication, governance, appointment/recruiting etc. To exemplify, analysis of the Congress' work breakdown structure shows that politicians simply cannot ignore actions related to funding to be elected with the current campaign funding system. The design flaw of the system forces candidates who want to be elected or re-elected to court funders, and funders might support candidates from which they can gather more benefits. The work breakdown structure is optimal if the granular goals are in harmony with overarching goal. If incentive system is flawed, members may not work for the purpose anymore. Measurement dysfunction manifests in form of employees working for the reward while deviating from the purpose. Analysing the compliance systems of banks, Kenny (2014) noticed that one of the reason of compliance managers' silence against faulty activities was the bonus system. Martin Woods, a whistle-blower of Wachovia bank, quotes: "The bonus quite rightly can be used as an incentive for people selling, and [it] is based upon the profit and loss of the division they work in, or their own sales. But within compliance and other areas including risk, all too often it's not used as an incentive; it's used to compromise you. [The bank] had one single control mechanism for [compliance] staff, and that was money" (Kenny, 2014, p. 170). A barrier that obstructs achievement of ascribed purpose can be bad communication and formalization. It is not uncommon that employees misinterpret an organisation's values or find them ambiguous (Ehrenhard & Fiorito, 2018). It should not be forgotten that this ambiguity might be purposely created. Organisational designs can be intentionally conceived with flaws so that institutional members can use them later to obtain benefits (M. S. Salter, 2010).

In the framework of institutional corruption, the victimisation is a collective construct that can diminish the public trust of an institution (G. C. Gray, 2013). Loss of public trust can be devastating for many institutions. Institutions can fall apart when

stakeholders such as customers, trading counter parties, employees and general public lose trust in the institution (M. S. Salter, 2010). If the institutions are public the loss of trust jeopardizes even the democracy itself. For example, many people sensing the institutional corruption in politics may decide not to vote (Light, 2013). If the institutions are private stock exchange companies, the lack of trust may cause investors' sale of owned equity (M. S. Salter, 2010). In both cases, the loss of trust by employees in their institutions would create serious intrinsic motivation problems, organisation against managers or owners, even possible strikes. The institutions would subsequently suffer from great ineffectiveness problems. For instance, Kesselheim et al. (2012) discovered that funding of a drug by a pharmaceutical company affects doctors' trust considerably. In an experiment with hypothetical drugs and 503 physicians, the physicians' willingness of prescription for drugs funded by private companies were two times less than their acceptance of drugs funded by National Institutes of Health. The presence of a conflict of interest changed doctors' perception of a drug even if the drug had a high methodological rigor. It can also be observed that, the trust in governments is constantly decreasing. The trust in US Congress hit a historical low in 2014 with 7% of people thinking that the Congress is trusted "a quiet deal" (Lessig, 2018). The situation is Europe is not much different: for instance, trust in national governments in southern European countries declined remarkably during the European debt crisis, see Figure 1 (Manchin, 2013).

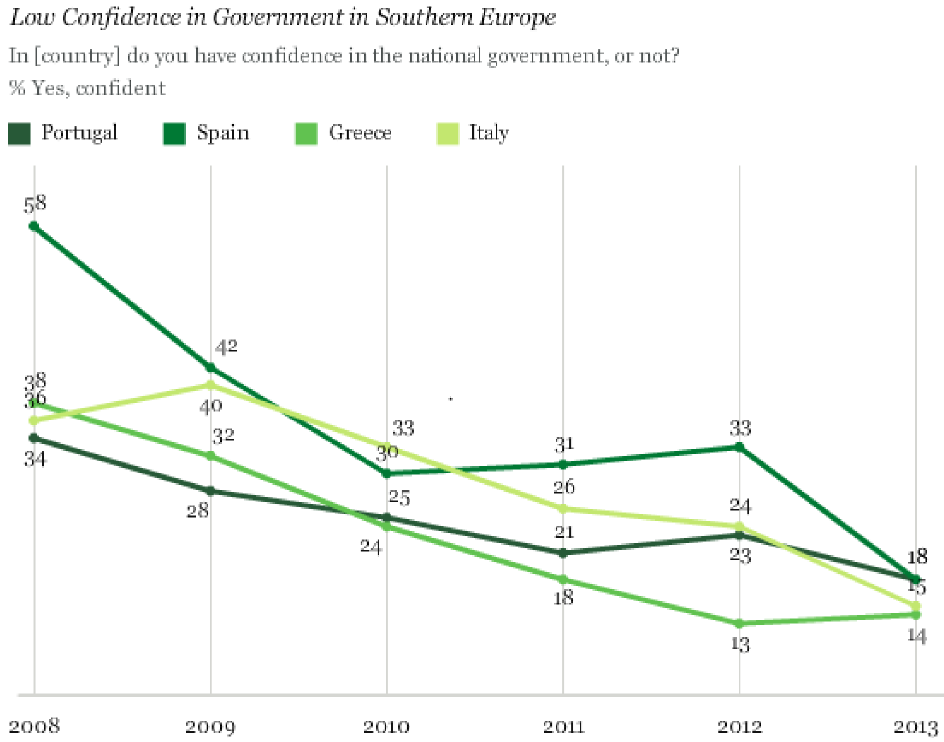

Figure 1: Trust in Southern European Governments, 2008-2013 (retrieved from Manchin, 2013)

The financial industry is equally marked by deteriorating faith. The trust in banks in US fell harshly between 2007 and 2009 and did not recover (McCarthy, 2016). European

countries take the lead in scepticism in banks together with USA with 37%. On the other hand, Asians seem to have very high trust in banking sector (Crabtree, 2013).

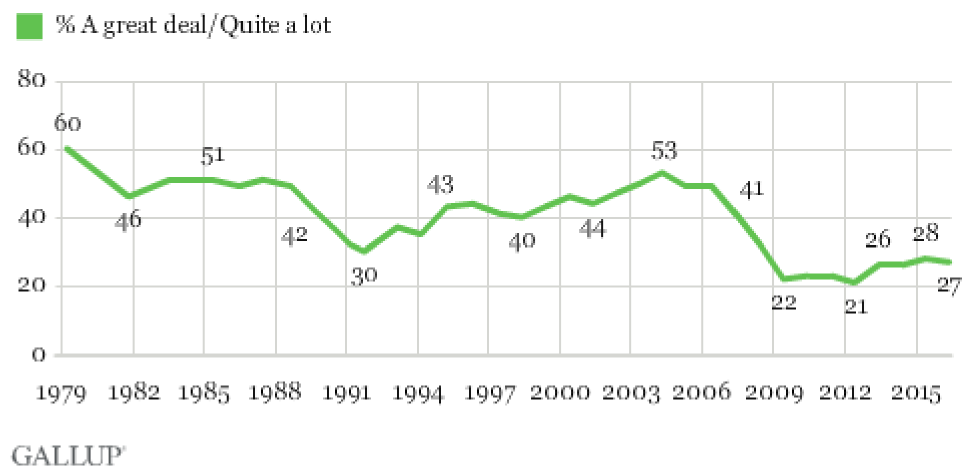

Figure 2: Americans' Confidence in Banks, 1979-2016 Trend (retrieved from McCarthy, 2016)

Although the loss of public trust is an indicator for institutional corruption, it cannot be solely used to identify IC. For instance, a temporal loss of trust in a company because of a defective product or in a university due to a controversial research, do not immediately indicate institutional corruption. Furthermore, public wishes influence trust and people have different demands. People can sometimes even wish for policies that are “short-sighted, socially destructive or morally wrong” (Light, 2013, p. 16). The purpose of elected politicians, which is “working for people” might result in actions which are against some people’s wishes. Ballantine et al. (2020) recommends the usage of the expression common good instead of public interest as it incorporates a moral dimension and altruism. Moreover, public trust can be manipulated for or against an institution. Nevertheless, such massive declines in public trust should be investigated since they do not occur without reason. Institutional corruption may be one of the options.

Finally, the reciprocal relationship between effectiveness and trust is worth mentioning. It is possible that an influence decreases effectiveness of an institution, but it is also possible that loss of trust diminishes effectiveness. This situation is noticeable in institutions that are based on trust like banks. A loss of trust can trigger considerable damages. Not only banks, but even whole countries can be victim of distrust. For instance, one of the reasons of European Central Bank’s bail-out intervention in Greece’s debt crisis was the fear of distrust contagion to other European countries (Buchheit & Gulati, 2013).

3 Institutional Corruption and Finance

During the trial of Credit Suisse trader Kareem Serageldin, the only executive who was sentenced after 2007-2009 financial crisis (Eisinger, 2014), the judge said that he was part of a larger “toxic culture” and that his criminality was a “small piece of an overall evil climate inside that bank and many other banks” (Kenny, 2014, p. 166). Especially, after the global crisis, people started to ask if the financial sector is totally corrupted.

There is a higher chance for institutional corruption in environments characterised by information asymmetries, complexity, and uncertainty. Financial sector is a forthcoming environment checking these conditions. Lack of transparency produces information asymmetries. Complexity is another characteristic since financial markets worldwide offer more than 76000 financial products. As many funds are managed according to Modern Portfolio Theory, working with a great number of different financial products including financial products from foreign financial markets, precious metals, raw materials etc. the complexity is excessive. Uncertainty is the result of the difficulty to predict future financial performance of products as they are affected by many factors. Moreover, a consistent outlook on the time span for analysis of financial performance is non-existent (Youngdahl, 2013).

This chapter will present a literature review on institutional corruption in the finance sector. Most of the mentioned papers are from the working paper series of Edmond J. Safra Research Lab. Yet, additional studies on the subject were also found through other sources.

3.1 Public Institutions

Most of the papers on institutional corruption analyse private actors. Yet, several public organisations were mentioned frequently. Securities and Exchange Commission (SEC) which is one of the most important financial regulators in USA showed examples of improper dependencies. A study by Project on Governmental Oversight revealed utilising public data that 400 former SEC employees planned to work for private sector between 2001 and 2010; for companies regulated by SEC. In another example, Jack Lew stated in his confirmation hearing that according to his employment agreement, his former employer Citigroup would provide him with a large sum of money if he would leave the company for an important governmental job (Youngdahl, 2013). Nevertheless, Salter (2013) examines the reactions of U.S Treasury and New York Federal Reserve Bank during AIG’s bailout. Unlike many critics who believe that AIG’s bailout was a perfect example of crony capitalism, he argues that no institutional corruption was observed. The reaction of public institutions that operated under

unprecedented conditions was the result of “improvised risk management”. The public institutions did not have clear regulatory authority but complete political accountability.

Mary Bathory Vidaver (2014) covers community development authorities and how they failed to achieve their institutional purpose. The case study of Virginia, accompanied by older examples of bond finance failures in California and Colorado outlines risk-shifting to homeowners, but also to bondholders by community development authorities. Speculative land-based bonds were sold to unsophisticated investors and their default caused conflicts between bondholders trying to collect the land back and homeowners willing to keep their homes on the same land.

A former executive board member of European Central Bank, Lorenzo Bini Smaghi (2009) highlights that complicated organisational characteristics can create conflicts of interest. For instance, Fannie May and Freddie Mac were shareholder companies with implicit state guarantee. Their mission of “promoting home ownership” was given from the state but the state was not responsible of checking their financial stability. This odd set of characteristics created conflict of interest between shareholders and taxpayers, as taxpayers would carry the costs of excessive risk-taking due to the state guarantee. After the crisis, both companies were not just saved by the government but also became public institutions (Frame et al., 2015).

3.2 Private Sector

The institutional corruption in private sector in general was analysed extensively by Malcolm Salter in his papers “*Lawful but Corrupt: Gaming and the Problem of Institutional Corruption in Private Sector*” (2010), “*How Short-Termism Invites Corruption…And What to Do About It*” (2012) and “*Annals of Crony Capitalism: Revisiting the AIG Bailout*” (2013).

In his papers, Salter identifies four activities promoting institutional corruption: violating norms of fairness, tolerating conflicts of interest, exploiting cronyism and gaming “society’s rules of the game”. Violating norms of fairness were broken by bankers who sold risky products to clients who were not aware of the hazard or by colossal bonuses paid to executives of investment bankers. Cronyism can especially be used through revolving doors. Government officials in important positions can help the financial sector to gain power. Concerning the gaming phenomenon, two types were identified: Rule-Making Game and Rule-Following Game. “Rule-Making (Influence) Game involves providing campaign contributions to politicians and lobbying them to include loopholes in new laws and then exploiting those loopholes, even when such behaviour subverts the laws’ intent. The Rule-Following (Compliance) Game involves complying technically with existing rules while exploiting their ambiguities for self-interested reasons” (M. S. Salter, 2010, p. 14).

Elizabeth Lewis (2015) outlines that the corporate bankruptcy law is shaped by special interests and used for terminating union contracts, edging out rivals, and avoiding product liability lawsuits. Since 2001, more than 50 companies abandoned their pension plans because of bankruptcy, exposing employees and retirees to great financial losses, and causing substantial deficit in the budget of Pension Benefit Guaranty Corporation. The corporate bankruptcy law is especially appealing for private equity firms, allowing them to misuse it as a profit strategy within their business model.

Lim and Tan (2015) analyse the role of rising transaction costs and they identify this factor as the most important trigger of 2007-2009 crisis. It is argued that factors such as complexity of financial instruments, excessive compensation structures or regulatory failures are secondary causes. The deregulation of financial markets in USA is given as an important explanation, not due its effects on lacking regulatory oversight but rather due to its effects on transaction costs. Furthermore, financial innovations increased the costs of moral hazard along with transactions.

3.2.1 Investment Consultants

Jay Youngdahl (2013) focuses on the role of investment consultants of retirement funds. First, it is important to mention that retirement funds are under great pressure; wages are not increasing, the worked hours by contributing workers are falling. Not to forget that members of baby boom generation are retiring or will be retired soon meaning that each working member must carry a heavier weight. Accompanied by a crisis struck investment period referred as “the lost decade of investment”, the tension on these funds’ investment returns are tremendous.

Consultants have a fiduciary duty to ensure benefit of their clients. Unlike lawyers who face severe consequences, if they breach their fiduciary duty, investment consultants would not confront such penances. The laws and regulations in which they pursue their operations are very ambiguous and the justification of the breach of duty is more difficult for consultants. Improper dependencies are present in many practices; especially the relationship of money managers and consultants is questionable. First, consultants offer “lessons” to money managers on how to pitch to trustees and members of pension funds to be selected by them. Astonishing sums reaching up to $200.000 can be demanded for such lessons. Second, consultants organise events in which money managers and trustees of a fund meet and then, they charge money from money managers for attendance. Additionally, they organise “educational trips” for trustees, who are not paid for their trustee duty, to locations such as Prague or St. Petersburg. These trips decrease trustees’ ability to contradict consultants in decision-making about money managers. Third, many consulting companies offer bundled services including insurance brokerage, benefit consulting or broker-dealer services using their gate-keeper status.

3.2.2 Tax Professionals

Tax avoidance is a severe problem both for developed and developing countries. Tax avoidance of large scale is done by entities that can afford technical expertise, such as big corporations and wealthy individuals. Consequently, it decreases funds that can be used to build common good in areas of infrastructure, healthcare, and education. Abusive tax avoidance requires creative and complex accounting methods to remain legal, exploiting the relevant laws' purpose (Brock & Russell, 2015). The authors offer an adapted version of Lessig's methodology to identify institutional corruption. The complex methods of tax avoidance of Wyly Offshore Network are analysed in a case study showing usage of tax havens, shell corporations and stock options. Furthermore, remedial responsibilities to decrease effects of abusive tax evasion are given for specific tax professionals: accountants, lawyers, and financial advisors. It is argued that tax professionals should participate in a collective act to enable required changes of norms and practices. The larger are the institutions the bigger should be the scale of actions to reduce tax evasion, giving the Big Four firms greater responsibility. Tax evasion is a good example of "compliance game" mentioned by Salter (2010). The legal rules are followed, but loopholes in laws are exploited causing detrimental effects for the society.

3.2.3 Rating Agencies

The affiliation between rating agencies and their customers is analysed by Lessig in "*America, Compromised*" (2018) as the most prominent example of institutional corruption in the finance sector. The rating agencies used to have a different business model; they were providing objective financial analysis to their subscribers. A regulation change took place in the 1970s as the Securities and Exchange Commission outsourced the regulatory task of rating and allocated a new mission to three agencies. Moody's, Standard & Poor, and Fitch became official asset graders. This switch meant that these agencies would issue licences to private investors like banks and investment houses. Since the private customers needing licences were at the same time business partners that could choose between the three agencies, the agencies were compelled to give favourable ratings to assets, for not losing their customers. This situation is seen as one the major reasons of financial crash in 2008 as millions of dollars' worth assets were overrated. The overrating obscured the fact that many products were almost valueless, paving the way for an unpredictable crisis. SEC gave a quasi-public mission to three private agencies without enforcing effective rules to control their objectivity.

3.2.4 Banks

New norms developed around late 1990s and early 2000s in banking sector; focus on profit and neglect of risk management. Banks concentrated on growth, quantity and scale while avoiding safety, even compliance and regulations (Kenny, 2014).

Kate Kenny (2014) analyses the organisational context which encompasses compliance in banking sector and how compliance personnel through organisational methods is prevented to exercise their tasks. Organisational analysis brings another perspective to failed compliance practices, as it was almost impossible for compliance officers to do their job under many systemic dysfunctions. Statements and interviews of compliance managers who were whistle-blowers were contemplated. First, compliance managers were placed on a low level of hierarchy; they could not talk to board without their superior's permission and many issues would not reach the executives. Second, an obvious absence of help for complaints was observed. No help was offered from Human Resources; additionally, administrative personnel would send needed documents very late. Third, they were part of a compensation system in which they might choose silence not to decrease their revenue but also their colleagues' revenue. Furthermore, they experienced many interpersonal problems and lack of respect as they were seen as "party spoilers". Temptation to avoid conflict and "blow the whistle on" their co-workers additionally contributed to their silence. When they spoke out, they were isolated or even threatened. All these issues caused a very high stress level and decrease of mental health. Ehrenhard and Fiorito (2018) equally notes that regulatory compliance requirements were acknowledged but not fixed during the scandals that were faced by 25 biggest European banks since 2010.

The prologue of New York Times bestseller "*All the Devils Are Here*" (McLean & Nocera, 2010) also starts with a similar story, but this time concerning risk management. John Breit, one of the most important risk managers of Merrill Lynch, was removed from trading floor to be exiled to a tiny office. His access to directors was cut. Many employees working on the risk department were later fired and their replacements often did not talk to Breit and even became hostile when they were asked about risky trades. Moreover, they did not deliver him needed data to analyse the risk. Later, in a meeting with the CEO Stan O'Neal, he noticed that the CEO neither realized how big the risk was and nor about the push-away of the risk management function.

Salter (2010) accused banking sector of "gaming" the newly established Dodd-Frank reform with the means of 3000 lobbyists and $57 million on campaign donations. In Dodd-Frank reform, the limit for Tier 1 capital of financial institutions was set as 3%. Yet, this limit did not change the risk situation of almost any bank apart from Goldman Sachs. Most of the banks had the same risk level prior to reform. Salter also highlights that the formulation and wording of this reform concerning the ban on proprietary trading and related investment forms is very ambiguous allowing future changes.

In another paper Salter (2012) mentions the conflict of interest created by Citigroup. The bank had a $500 million short position against the assets that it assisted to select for its clients. This situation meant that, Citigroup would win money if the funds chosen for their clients would lose value, creating an undisclosed economic interest. Shortly after the trade, 6 months later in November 2007, the funds' value declined because of asset downgrading by rating agencies. Then, with the fall of mortgage market, 15 clients of Citigroup lost $700 million while the bank earned $160 million from their short position. The case of nondisclosure was then settled with SEC for $285 million. Although this agreement, alleging the bank just with negligence and no wrongdoing was formerly rejected by U.S. District Court Judge Jed Rakoff, it ended up being approved (Ax, 2014).

Justin O'Brien focuses on LIBOR scandal in his three papers "*Culture Wars: Rate Manipulation, Institutional Corruption and the Lost Underpinnings of Market Conduct Regulation"* (2013a), "*Singapore Sling: How Coercion May Cure the Hangover in Financial Benchmark Governance"* (2013b), and "*Fixing the Fix: Governance, Culture, Ethics, and the Extending Perimeter of Financial Regulation"* (2014). London Interbank Offered Rate (LIBOR) scandal involves systematic manipulation of reference rate in London to increase profit of derivatives and give false information about banks' financial situation. These manipulations date back to 2005, even before the global crisis with involved banks being Deutsche Bank, Barclays, UBS, Rabobank, HSBC, Credit Suisse, Lloyds, WestLB, the Royal Bank of Scotland, Bank of America, Citigroup, JPMorgan Chase, and the Bank of Tokyo Mitsubishi (McBride, 2016).

In the paper "*Culture Wars"* (O'Brien, 2013a), the author analyses the New Deal reform program established by James Landis in 1933 for recovery from the Great Depression. The New Deal's foundation was based on corporate purposes, having similarities with the concept of institutional corruption as purpose plays a vital role in both cases. O'Brien stresses that the code of conduct created by International Organisation for Securities Commission (IOSCO) after LIBOR crisis alarmingly lacks specificity. In the second paper "*Singapore Sling"* (O'Brien, 2013b), he explores in detail the innovative reforms by the Monetary Authority of Singapore (MAS) to assure the integrity of interbank ratings after the scandal. In their model three criteria are vital. First, unlike the IOSCO model, obligation should be precise. Second, external review is required to evaluate behaviour of the employees. Third, internal risk management systems are essential to assure public benefit of the reference rates. Moreover, MAS has a substantial authority over banks with specific legal powers. The focus on "*Fixing the Fix: Governance, Culture, Ethics, and the Extending Perimeter of Financial Regulation"* (2014) lies on drawbacks of regulatory changes in UK and USA.

Katrin Carson (2017) concentrates on incentive compatibility and analyses it in two case studies: the Congress and the LIBOR benchmark. She argues that incentive

incompatibility of banks' setting the LIBOR is flawed because submitters can influence their earnings through their submissions. The daily LIBOR submissions are based on subjective evaluation of borrowing rates. The proposed suggestions to mitigate this issue are establishing a system in which rates based on real transactions or a system facilitating whistle blowing, also utilised by MAS in Singapore.

4 Case Study Institutions

As the financial sector will be analysed within the framework of institutional corruption, it is crucial to identify a purpose (Lessig, 2013) or a function (Taylor, 2014). A purpose for the whole sector as well as purpose of different institutions of the sector will be given. Youngdahl (2013, p. 45) expresses the reason of existence of financial sector as “the purpose of finance, historically, has been to provide a system for human business activities to function.” At the most fundamental level, finance is an intersection point between an entity that needs money and another entity that can provide it. This principle is relevant for loans of every scale. A bank can provide a loan for someone to purchase a house or in stock exchange market large firms meet with investors. In last decades, the initial role of finance was altered due to many factors such as deregulations, technological advancements, and high-level competition. Finance was transformed gradually to an end itself, producing money out of money while financial markets grew to be multiple times larger than real economies. The initial role of finance should be considered again for a sustainable development and future; “an instrument at the service of economic, trade and human activities, and not an end in itself: to produce money out of money in the shortest possible time” (Baranes, 2009, p. 416).

4.1 European Central Bank

4.1.1 Mission and Goals

The mission and the vision of the European Central Bank can be taken from legal documents on frameworks as well as from the institution's website that provides a decent overview on how ECB works. Unlike some private organisations which do not give detailed information, ECB offers knowledge about its tasks as well as its understanding of independence, transparency, accountability, corporate governance, and ethics. The additional information facilitates the analysis of its goals and sheds light on the manner how the goals are achieved.

The differences between European Central Bank, European System of Central Banks (ESCB) and Eurosystem are explained in TFEU O.J. C 326/47 (*Protocol (No 4)*, 2012). ESCB includes ECB and national central banks of EU countries. On the other hand, Eurosystem comprises ECB and the countries that adopted euro as their currency. According to Article 2, ECB's main objective is maintaining price stability, consequently safeguarding the value of euro, and avoiding sharp inflation fluctuations for common good. The aimed inflation rate is just below 2% over the medium term. Moreover, ECB has tasks concerning banking supervision, banknotes, statistics, macro prudential policy and financial stability. While respecting the separation of monetary policy and supervisory duties, the safety of European financial system alongside the safety of banking system is also a task of ECB. This goal was attributed to ECB since the introduction of Single Supervisory Mechanism (SSM) with the Regulation No 1024/2013 (*Council Regulation (EU) No 1024/2013*, 2013).

Additionally, European Central Bank highlights in many occasions the importance of transparency. ECB's mission states: "In performing our tasks, we are transparent while fully observing the applicable confidentiality requirements" (European Central Bank, n.d.-b), and the Eurosystem statement declares: "In pursuing our objectives, we attach utmost importance to credibility, trust, transparency and accountability. We aim for effective communication with the citizens of Europe" (European Central Bank, n.d.-c).

4.1.2 Institutional Design

The precedent of ECB, the Economic and Monetary Union (EMU) came into force on the first of July 1990 in the European Union. EMU granted complete freedom of transaction between the member states and established a common monetary authority implementing a single monetary policy. The Euro as a currency was introduced in 1st of January 1999 and was used three years long as an invisible accounting currency until its launch as cash in 1st of January 2002. Nineteen of the twenty-seven members are currently using this currency. ECB was founded in 1st of January 1999 and now controlling the monetary policy of the world's second largest economy after USA.

ECB's responsibility was extended in 2014 by including the supervision of banks, within the framework of a single supervisory mechanism. ECB's pillars of independence are given as institutional, personal, functional and operational, financial and organisational, legal and also political independence (*Protocol (No 4)*, 2012, Article 7).

The decisions are taken by Governing Council constituted by six members of Executive Board and the governors of national central banks of nineteen countries which adopted euro as their currency. Although the council has twenty-five members, they cannot all vote in every session. The six executive members have a continuous right, the five biggest economies, Germany, France, Italy, Spain, and Netherlands have four votes and the other fourteen countries have eleven votes, creating a total of twenty-one votes for decision-making. The rotation happens every month, changing the voters but the participation to meeting and right to speech is on-going (*Protocol (No 4)*, 2012, Article 10). It is worth mentioning that an unspoken rule for the six executive members exists; they cannot be from the same country. When Mario Draghi was chosen as the new president of ECB, French President Nicolas Sarkozy urged the other Italian member of the executive board, Lorenzo Bini Smaghi to step down (Flynn & Guarascio, 2011). After extensive pressure, Smaghi did then quit his position (Reuters, 2011). The executive members are selected for eight years and cannot be reappointed. National central bank governors have a minimum term of five year. It is possible that a member loses the given position in case of a serious misconduct.

ECB and the central banks have their own income sources. The capital arrives from all the central banks, while the central banks from non-eurozone only pay operational costs. The current capital of ECB is 10,8 billion euros. The sum that each country should contribute is calculated according to countries' share of the total gross domestic product (GDP) and population, both factors having the same weight (European Central Bank, 2020a). This actual sum is considerably higher than cited sum of 5000 million euros in 2012 (*Protocol (No 4)*, 2012). The governing council can adjust the sum according to requirements.

4.1.3 Analysis within the Scope of Institutional Corruption

The systemic and strategic influences of revolving doors, closed policy circles, capital flight and too-big-to-fail were documented by Kalaitzake (2019) in an analysis of European Central Bank. The author proclaims that private financial actors used them to direct ECB decisions in their favour during the European debt crisis. Moreover, the economic heterogeneity of Eurozone countries is an additional vital systemic influence.

Revolving Door

The phenomenon of revolving door was previously documented on the second chapter. For instance, Lorenzo Bini Smaghi was urged to resign in December 2011 by

Nicolas Sarkozy after Mario Draghi was appointed as the president of ECB. In 2005, he became the chairman of the one of the biggest French banks, Société Générale. In another case, a former executive board member, Ottmar Issing became a Goldman Sachs Advisor in less than six months after leaving the job, when ECB used to have no cooling-off period at all (Transparency International, 2013). An overview of revolving door practices and memberships to elite financial and political clubs concerning ECB is giving by Kalaitzake (2019). Now, the cooling-off periods of ECB according to "*Code of Conduct for high-level European Central Bank Officials"* are existent, but still relatively low (European Central Bank, 2019, Article 17):

- One year for credit institutions,
- Six months for other financial institutions, and
- Six months for organisations that lobby ECB

Even though former members must inform about their occupation in the next two years after job cessation, they can work in a credit institution after one year or in a company involved with ECB lobbying just after six months. Although there are some executive members who chose the private sector, ECB did not suffer from concerning cases of revolving door like José Manuel Barroso, the former president of European Commission who took a position in Goldman Sachs (Amaro, 2018) or Adam Farkas, the former executive manager of European Banking Authority who transitioned to the biggest financial lobbying institution in Europe, Association for Financial Markets in Europe (AFME) as the chief executive officer (Corporate Europe Observatory, 2019).

Closed Policy Circles

The presence of closed policy circles is another strategic influence which might influence the decisions of ECB. Corporate Europe Observatory, a non-profit organisation dedicated to the investigation of lobbying in the European Union, revealed that 508 seats out of 517 in ECB's advisory groups, meaning a percentage of 98,3 were given to representatives of private financial institutions (Haar, 2017).

Moreover, two third of the seats were occupied by financial companies directly supervised by ECB with banks such as Deutsche Bank (18 seats), BNP Paribas (17), Société Générale (16), UniCredit (15), Commerzbank (13). In addition, 64 entities out of a total of 144 were not listed in EU Transparency Register. These numbers show clear problems concerning ECB's choice of expert help. First, the objectivity of bank's decisions will be questioned as such a dominance of corporate firms can create biased decisions in favour of private financial organisations. Such a mixture of experts can diminish ECB's effectiveness in decision-making. Second, the unwillingness of ECB to balance the sources of expert opinion will decrease public trust in the bank since only two consumer representatives have seats. Third, the high number of unregistered interest representatives is not compatible with ECB's transparency goals.

Figure 3: Advisers of the ECB (retrieved from Haar, 2017)

Another case of a closed policy circle is underlined by the membership of Mario Draghi, the former president of ECB, to the Group of Thirty (G30). The organisation was founded in 1978 with the help of Rockefeller Foundation, the members are welcomed by personal invitation from the group and it is known as a secretive group not publishing protocols after meetings (Canepa, 2018). The Group of Thirty presents itself as a consultative non-for-profit organisation supported by many central banks as well as private firms such as BNP Paribas, HSBC, BlackRock, KPMG (Group of 30, n.d.). Its members also include presidents of national banks along with top executives of private organisations. The non-profit lobbying watchdog, Corporate Europe Observatory filed a formal complaint on February 2012 to ECB's executive board urging Draghi to step down from this organisation characterised with opaque meetings due to conflicts of interest and breach of ECB's ethical conduct. After the complaint was rejected by ECB's board, they carried it to the EU Ombudsman, who accepted the complaint and the case was opened. The allegation in the letter was that the Draghi's membership of the Group of 30 is incompatible with the independence, reputation, and integrity of the ECB. Later, the Ombudsman, P.Nikiforos Diamandouros rejected the allegation arguing that members and financing of G30 are not just provided by private firms but also from public bodies (Diamandouros, 2012). Since the extension of ECB's spectrum of tasks in August 2014 by including the supervision of banks, Draghi's G30 membership became a more serious issue as some of the G30 members were chief executive officers of supervised banks. SSM Regulation states: “in order to carry out its supervisory tasks effectively, the ECB should exercise the supervisory tasks conferred on it in full independence, in particular free from undue political influence and from industry interference which would affect its operational independence” (Council

Regulation (EU) No 1024/2013, 2013, p. 72). Corporate Europe Observatory filed then another formal complaint in 2016, this time to another Ombudsman, Emily O'Reilly. The result of the complaint was different in this occasion as the Ombudsman found maladministration (European Ombudsman, 2018). Emily O'Reilly recommended in January 2018, Mario Draghi to suspend his membership, moreover, urged any member of ECB not to be a part of G30. The recommendation was rejected by ECB and Draghi did not suspend its membership to G30. The main problem in this case was not that Draghi's judgment was jeopardised by his G30 membership but the transparency problems of this organisation such as unpublished contents of meetings, the opacity concerning appointment of its members etc., plus the threat to ECB's reputational damage.

Not only G30 but also elite organisations such as Institute of International Finance (IIF), Trilateral Commission and Bilderberg Steering Committee found representation in ECB (Kalaitzake, 2019). IIF's disproportionate level of influence in the restructuring of the Greek debt, ensuring bond repayments with European tax income and resulting in extensive austerity measures for Greek citizens is documented in another paper by Kalaitzake (2017). IIF also played a crucial role on the adjustments of Basel agreements favouring private financial institutions (Lall, 2012). Unlike G30's public-private mixture, IIF was founded by 38 banks and its board members are mainly high executives from the biggest financial corporations (Institute of International Finance, n.d.). The former ECB president Jean Claude-Trichet was the chairman of IIF's Group of Trustees. The next chairman after Trichet's departure was Christian Noyer, ECB's vice-president. Also, other members of ECB's executive board such as Lorenzo Bini, Smaghi and Jörg Asmussen were part of the organisation. Furthermore, since 2012 IIF is listed in EU Lobby Register. Their spending grew gradually and in 2018, the organisation was registered with two non-accredited lobbyists and a spending of 600.000-699.999 euros (LobbyFacts.eu, n.d.-b). Although it is difficult to justify the direct effects of the membership in decision-making process, the secretive regulators-regulated relationship and meetings behind closed doors harms the image of ECB as well as their transparency and accountability policy. The damage of effectivity in decision making is a possible outcome but the damage of the public trust is an undeniable matter. Although IIF memberships did attract less public attention than G30 memberships, the facts show that they are more harmful for operational independence of ECB.

Capital Flight/Disinvestment

Capital flight or disinvestment is given as another influence mechanism. Investors from banks and non-bank financial institutions can put big pressure on developing countries and on their currency. During the Eurozone crisis, investors shifted deposits from periphery banks to central banks but also bonds from periphery states to safer states

like Germany creating large gaps between interest rates of financially stronger and weaker EU Members, see Figure 4. Additionally, periphery banks were restricted to obtain interbank loans posing liquidity problems. All these mechanisms, are forcing ECB to intervene as the regulatory authority (Kalaitzake, 2019).

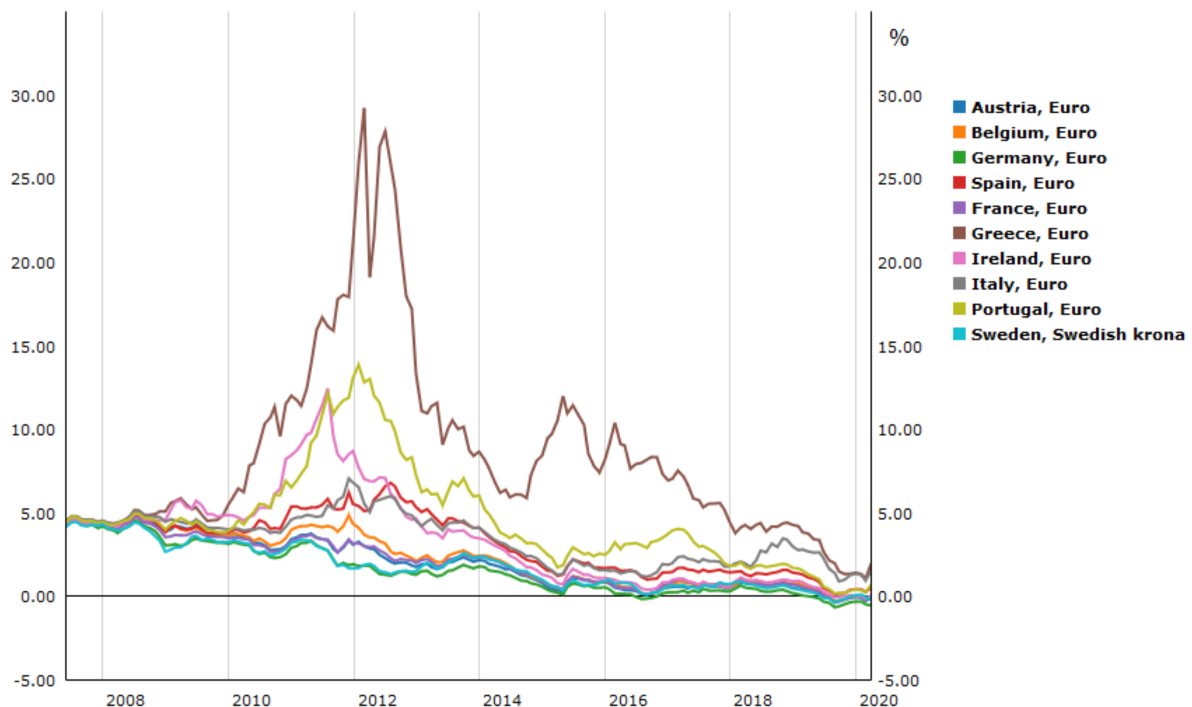

Figure 4: The change of long-term interest rates between 2007 and 2020 for selected countries (adapted from European Central Bank, n.d.-a)

The fear of contagion and resulting fear of capital flight shaped ECB's management of Greece's debt crisis. The intervention through bailout, consequently with taxpayers' money was motivated by avoiding capital flight from other economies of countries such as Italy and Spain. If restructuring of the debt was preferred instead of the bailout, bond holders of other countries might have sold their assets and accelerated or even caused other debt crises (Buchheit & Gulati, 2013).

Too-big-to-fail

Too-big-to-fail (TBTF) is now a known dilemma. The bankruptcy of Lehmann Brothers showed that the failing of a big and vastly connected financial institution can cause a cross-border crisis. It is a challenge to control the risk-taking willingness and moral hazard of big financial firms while preserving economic stability and growth. The bankruptcy of a big European bank would not just have national effects but can also damage the whole Eurozone and the value of the euro compared with other currencies. ECB is obviously affected by this dilemma as its primary mission is preserving the value of the currency. For instance, a sharp decrease in the currency's value can create inflation for imported products. Furthermore, since 2014, ECB has a supervision

responsibility for the systemically important banks within the framework of Single Supervisory Mechanism. As of March 2020, SSM monitors 115 largest European banks (European Central Bank, 2020c).

The effects of the systemic influences of capital flight and TBTF could be observed during the crises of Ireland and Greece. It was seen that ECB was clearly opposed to the relocation of private losses to investors during both crises, resulting in harsh austerity measures for citizens. In case of Ireland, the president of ECB, Trichet, sent two secret letters that were later published by ECB, urging not to punish investors (European Central Bank, 2014). Ireland gave then a guarantee of 440 billion dollars to banking sector, a sum that is worth two times more than the country's GDP and introduced an austerity programme. Also, for Greece, ECB played a very important role as Trichet along with other members such as Jürgen Stark and Lorenzo Bini Smaghi were against the restructuring of the debt in 2010. In 2012, a partial restructuring was accepted but the delay of two years resulted in 100 billion dollars of private debt moving to public balance sheet (Kalaitzake, 2019). On the one hand, in both occasions, ECB had reasons to act in such a manner. First, a country that is punishing investors during crisis times could set an example for future cases resulting in capital flight and investment aversion. Second, systemically important, mainly French and German banks were holding 75% of the Greek debt. Bailing out Greece as a country was a politically more acceptable approach compared with bailing out overexposed private banks (Buchheit & Gulati, 2013). On the other hand, banks not taking responsibility for bad investments and pushing the debt to taxpayers, thus public institutions such as ECB permitting it, is an immense problem. Although Lorenzo Bini Smaghi published a paper about conflicts of interest of ECB in 2009 after the crisis, none of the four previously mentioned influences and conflict of interests created by them were stated (Bini Smaghi, 2009).

Economic Heterogeneity of the Eurozone

The fact that European countries using Euro as a currency do not have the same economic strength is challenging ECB. One of the important names of sustainable and ethical finance, Andrea Baranes wrote after the 2008 financial crisis about its possible impacts for countries with weaker economies: "to try to revive their weak economies out of the crisis, the poor countries will have to try and place public treasury bonds into an over-crowded and weak financial market. The bonds from the strongest economies that put out their own bailout plan, will force the small southern economies to grant very high interest rates to the potential investors, to attract them. It is likely that these high interest rates may bring about a new debt crisis for several countries. The weakness of their currencies will only add to their economic and monetary problems in the next future. The only other chance for these same countries is to rely on the intervention of the International Monetary Fund and the other international financial

institutions. These countries know from recent history how heavy the consequences of such an intervention may be" (Baranes, 2009, p. 419). Starting in May 2010 with Greece, then catching Ireland and Portugal and finally damaging bigger economies such as Italy and Spain, the peripheral European countries found themselves in a debt crisis (Buchheit & Gulati, 2013).

4.1.4 Solution Suggestions

Revolving Door and Closed Policy Circles

At first glance, there are two obvious suggestions to avoid revolving door. The first one concerns the choosing of candidates. Executive board members are chosen by the European Council after consultation of European Parliament. The other members of the Governing Council are selected by national authorities as they are governors of respective central banks. The EU Council should be careful appointing the president as well as other members. Their decision must be accountable, and they must consider factual and perceived independence of ECB. The Council should not choose candidates that will jeopardize the public trust of the European Central Bank. The considered candidates, in addition to be highly qualified for their job, should not have background of lobbying or memberships in opaque organisations. Moreover, the suggestions of European Ombudsman must be taken seriously as it was recommended that the members of ECB should not be part of opaque organisations like G30. A reason of hiring candidates with private sector background is their high qualification and naturally their knowledge of the private sector. The observation of the current members of Executive Board shows that suitable appointments were done. The president, Christine Lagarde's career is marked by public positions in French government and her presidency of IMF. Contrarily, the vice president Luis de Guindos has a history of revolving door as he changed positions between private and public sector more than once. Yves Mersch and Fabio Panetta both worked in important national government positions and international organisations. Philip R. Lane was an academician, who became the governor of Central Bank of Ireland before entering the executive board. Finally, Isabel Schnabel, the German member of the board was an academician and scientific consultant for EU organisations (European Central Bank, 2020b). Such a composition of the Executive Board is adequate. Accordingly, the revolving door experience of Luis de Guindos does not stand out, he seems to be the member of the board with a deep private sector experience, a necessary addition. Yet, the example of Otmar Issing, who did not previously work in private sector but joined Goldman Sachs right after his public post, shows that laws forbidding such moves are necessary. The salary difference for highly qualified senior employees between public sector and private sector is high. Brezis (2017) arguments that public institutions "close their eyes" and do not take action on conflicts of interest in order to profit from services of highly qualified employees. Public organisations should reconsider their hiring

process and find ways to “catch” high potentials from the beginning of their career. It is easier to do that in early level because the salary difference is lower. They should also consider developing competent talent management programmes to keep qualified employees.

At the second level, the departure of former members to private organisation that are directly related to ECB’s working spectrum should be avoided. Accordingly, the appropriate selection of members is equally vital in this situation. For instance, there is a higher chance that an academician like Isabel Schnabel would return to teaching after leaving her position in executive board. Furthermore, policies concerning cooling-off periods are crucial. However, as it was previously documented, the cooling-off periods for ECB’s high officials are still very short. The main argument for such short cooling-off periods is the right to engage in a chosen work. “*The Charter of Fundamental Rights of the European Union”* cites “Everyone has the right to engage in work and to pursue a freely chosen or accepted occupation” (2012, p. 398). Yet, if this argument is pursued, cooling-off periods should not exist at all. If they should exist and they do exist, the appropriate waiting period of six month before starting to work in a lobby organisation is not acceptable. Such qualified candidates can surely obtain positions that are not in credit institutions directly supervised by ECB or in European lobby organisations. The former members must notify ECB on their occupation in the two-year period (European Central Bank, 2019, Article 17). The mentioned two years should not be solely about providing information. A cooling-off period of two years must be obligatory for such important public servants. One of the tasks of ECB is controlling systemically important banks, with the same spirit the former high officials of ECB are systemically important public servants. Their ethical behaviour should not be only left to their personal integrity, but it must be ensured through law. The case of Adam Farkas, the former Chief Executive Director of European Banking Authority, which is analysed in the next chapter, proves that former public servants can make questionable decisions.

Too-big-to-fail, Capital Flight/Disinvestment and Economic Heterogeneity of the Eurozone

The solutions to these matters are very complicated and will not be analysed in detail. In fact, too-big-to fail caused a complete change in ECB’s organisational structure. This influence is so vital that SSM was established, creating an entity of supervision within the institution. The influence of capital flight is an external factor and difficult to eliminate with simple organisational changes. It is important to attract and keep the investors, but methods to do it can create problems. One of the reasons of sovereign debt crisis was in fact offered high interest rates to attract investors. Economic heterogeneity is a systemic influence. The fact that many European countries use the same currency without possessing the same economic power has its disadvantages.

The relevant problems are more visible in financial crises. The investors prefer bonds of stable countries such as Germany and France, putting pressure on peripheral countries. Through weakening economic power of Spain and Italy and, especially with the Brexit, the dominance of Germany and France peaked. Now, after the epidemic crisis, it appears that Germany will come out with less damage than other countries, consolidating its power. The future will show how the common currency of Euro will emerge.

4.2 European Banking Authority

4.2.1 Mission and Goals

The foundation of European Banking Authority as a supranational regulator dates to September 2009 along with other institutions since EU decided to cope with the effects of financial crisis and systemic risks using a new supervisory architectural package (Fahey, 2011). Following the Larosière Report recommending a coherent supervisory authority, the Committee of European Banking Supervisors was divided into three organisations: European Banking Authority, European Insurance and Occupational Pensions Authority, and European Securities and Markets Authority. Moreover, European Systemic Risk Board was created as an additional institution and they all started operating in 2011 (J.-P. Salter, 2019).

The creation purpose of the organisation according to Regulation 1093/2010 is "to protect the public interest by contributing to the short, medium and long-term stability and effectiveness of the financial system, for the Union economy, its citizens and businesses" (*Regulation (EU) No 1093/2010*, 2010, p. 21). The tasks of EBA are given in Article 8 and summarised in their official website. The principal goal of the EBA is the creation of the European Single Rule Book in banking with the help of technical standards and guidelines. EBA is also responsible for assessing the risk of vulnerabilities of European banks with report and stress tests. Moreover, the institution promotes convergence of supervisory procedures to guarantee a coherent application of prudential rules. Other supplementary tasks are given as (European Banking Authority, 2018b):

- *"investigating alleged incorrect or insufficient application of EU law by national authorities*
- *taking decisions directed at individual competent authorities or financial institutions in emergency situations*
- *mediating to resolve disagreements between competent authorities in cross-border situations*
- *acting as an independent advisory body to the European Parliament, the Council or the Commission.*
- *taking a leading role in promoting transparency, simplicity and fairness in the market for consumer financial products or services across the internal market."*

4.2.2 Institutional Design

European Banking Authority follows its duties in a complex system of institutions. As it can be observed by contemplating its tasks, EBA has a limited spectrum of enforcement power. The institution can only interfere in emergency situations or in case of disagreement between certain competent authorities. The decision power belongs to European Commission in most cases and EBA acts as an independent advisor. The reason behind this structure is the Meroni doctrine imposing that regulatory powers cannot be delegated to agencies (Fahey, 2011). EBA is also

required to present an annual work programme to be ratified by the Commission (J.-P. Salter, 2019). Furthermore, the organisation is also cooperating with competent national authorities as well as the European Central Bank. Its seat has been moved from London to Paris after the Brexit.

The financial revenues are provided by contributions from EU national competent authorities (30,5 million euros in 2020), contributions from EU (19 million euros) and minor contributions from non-EU countries that are in free trade association (0,9 million euros). The institution do not generate its own revenue (European Banking Authority, 2019a).

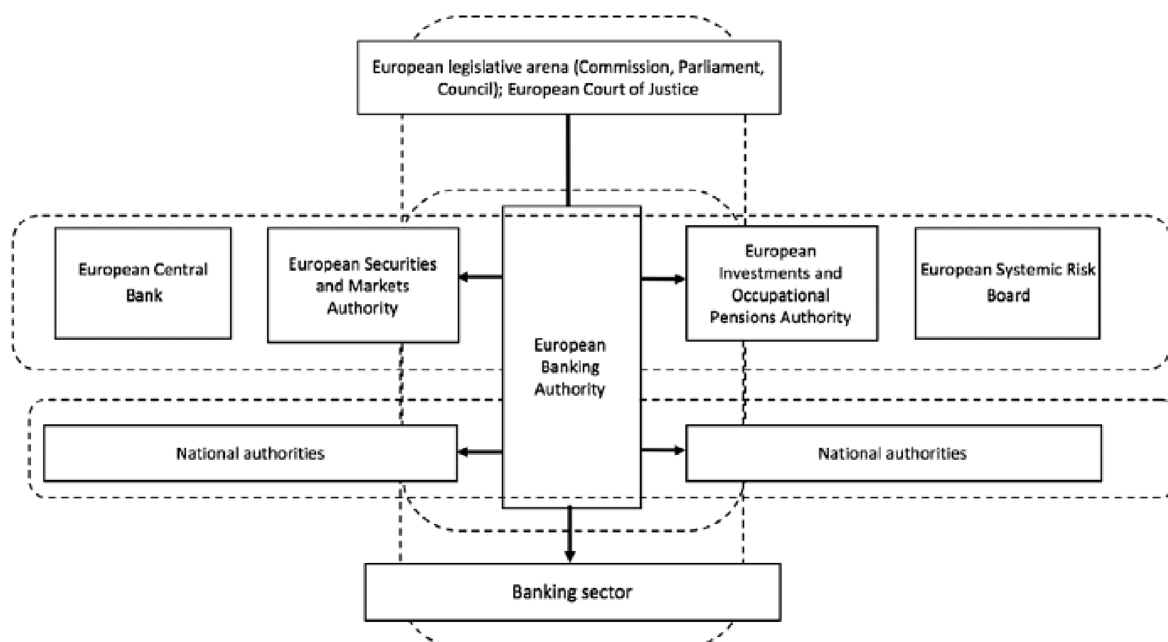

Figure 5: EBA's Institutional Context (retrieved from J.-P. Salter, 2019)

Concerning its governance, EBA has two employees belonging to senior management; a Chairperson who is the face of the organisation and an Executive Director accomplishing daily activities. The Chairperson is since March 2019 José Manuel Campa (European Banking Authority, 2019d), who left his job as the Global Head of Regulatory Affairs of Grupo Santander. The Executive director is as of March 2020 non-existing since the prior employee Adam Farkas switched to private sector. According to Articles 48 and 50, they are both appointed by the Board of Supervisors. Furthermore, the appointment of the executive director must be confirmed by European Parliament. They are both elected for five years with the possibility of a second term (*Regulation (EU) No 1093/2010*, 2010).

There are two important boards; the Board of Supervisors (BoS) with 27 voting members from every EU country and 10 observing members, is responsible for decision making and the Management Board (MB) with seven members (including the Chairman and 6 elected members from BoS) ensures that EBA continues its mission

and tasks properly. Additionally, Board of Supervisors delegate resolution related processes to Resolution Committee (ResCo) and they work with newly established internal Standing Committee on Anti-Money Laundering and Countering Terrorist Financing (AMLSF) as well as other European Supervisory Authorities in necessary occasions (European Banking Authority, 2019c). A Board of Appeal exist for disagreements between competent authorities or sectors. EBA has also a committee called Banking Stakeholder Group with 30 members chosen to embody credit and investment institutions, consumer representatives, users, and academics. At least five of its members must be independent top-ranking academics. Ten of its members must embody financial institutions. They meet the Board of Supervisors at least twice a year and share their recommendations. They are appointed by the BoS (*Regulation (EU) No 1093/2010*, 2010, Article 37).

Figure 6: EBA's Governance Structure (adapted from European Banking Authority, 2019c)

Decision-making mechanisms of the boards differ. The seven members of the management board decide using a simple majority. Since the chairman is one of the members, he can vote. On the other hand, decision-making of the Board of Supervisors is more complicated and has different arrangements for specific occasions. Normally, the 27 members from EU countries decide by a simple majority and the chairman does not have a vote. Concerning the matters of “regulatory technical standards” (Article 10 to 15), plus “guidelines and recommendations” (Article 16), they vote based on a qualified majority. Regarding the matters of “breach of Union law” (Article 17), “action in emergency situations” (Article 18), “settlement of disagreements between competent

authorities in cross- border situations” (Article 19), the BoS vote based on double simple majority. This majority is obtained when the members of Eurozone have a majority between them, and the members of non-Eurozone have their own majority, plus the simple majority in total must be attained (*Regulation (EU) No 1093/2010, 2010, Article 44)*.

4.2.3 Analysis within the Scope of Institutional Corruption

Previously mentioned strategic and systemic influences for ECB are also relevant for EBA. Yet, EBA is less influenced by the matters of too-big-to-fail and capital flight since the institution has limited intervention power. Moreover, ECB became responsible for the supervision of the largest European banks after the introduction of SSM. On the other hand, the problem of revolving door that was showcased in EBA becomes a perfect example of the phenomenon and it will be analysed in detail. Furthermore, unlike ECB, which is a very independent institution, EBA has dependency issues concerning decision-making due to its legal status as an agency and its governance structure. First, the institution is very dependent on national competent authorities. All the voting members of the Supervisory Board making policy decisions are representatives of national competent authorities. Second, in most of the cases, the direct decision power is on the hands of European Commission.

Revolving Door

The revolving door case of the European Banking Authority is very interesting because it concerns high-ranked public officials. Moreover, it occurs in both directions; the chief executive officer leaving his office to become the director of Association for Financial Markets (AFME), the biggest financial lobby in Europe and the new appointed chief executive officer who previously worked in the same lobby organisation. The appointments and decisions of the European Banking Authority along the whole process show that the credibility and accountability of a very important EU organisation were not taken seriously. The occurred events were detrimental for the trust of EU Parliament, Council and Commission as well as European citizens.

First, José Manuel Campa was chosen as the chairman by board of supervisors and his position prior to EBA’s Chairman is problematic. The Global Head of Regulatory Affairs is a job ensuring compliance of an organisation’s actions but also a job having internal lobbying characteristics looking to loosen up regulations. Dialer and Richter (2019, p. 8) mention that “lobbyists rather call themselves Public Policy Manager, Head of Government Relations, Director External Liaison, EU Coordinator, Policy Director, Head of Advocacy, European Affairs Manager, Secretary General, or simply Head of Brussels Office”. Campa was executing his tasks for one of the Europe’s biggest banks, Grupo Santander which is in the 2019 global list of systemically important banks of Financial Stability Board (Financial Stability Board, 2019). Some sources refer

Campa as the top lobby chef of Santander (Mondovisione, 2019; Lindo, 2019). The observation of Banking Stakeholder Group's meeting on February 2019 reveals that certain stakeholders were not happy with Campa's designation. One of the members expressed that: "the revolving doors practice should have been removed at EU level, and consumer representatives have trouble trusting a EU supervisor/regulator coming from the banking industry" (European Banking Authority, 2019e, p. 2). Furthermore, José Manuel Campa indicated that his employment and the related enumeration package of unvested Banco de Santander company shares as types of conflicts (European Banking Authority, 2019b). He declared that he sold all the other owned company shares. Since vested shares only mature after a certain period, they cannot be touched and consequently sold. Nevertheless, owning shares of one of the largest European banks while operating as a chairman of EBA is inconvenient.

Type of conflict (as per Article 1)

[ ] Membership of a body with an interest in the subject matter
[x] Employment (including being a SNE or on unpaid leave)
[ ] Consultancy
[ ] Intellectual property
[ ] Other memberships
[ ] Other (e.g. gainful employment of the spouse in the financial sector)

[ ] No conflict of interest to be declared

Figure 7: Types of Conflict of Interest for José Manuel Campa (retrieved from European Banking Authority, 2019b)

Second, Adam Farkas who has been the executive director of EBA since the founding of the organisation in 2011, left the institution on February 2020, in order to become the executive director of Association for Financial Markets (Jones, 2019). AFME is the biggest financial lobbying organisation in Europe with a spending of 4,7 million euros (Dialer & Richter, 2019). AFME's spending was even higher during the times of tough regulation after the crisis as the official lobby spending of the organisation is given to be 10 million euros annually for the years 2010, 2011 and 2012 (LobbyFacts.eu, n.d.-a). A closer look to the organisation's board unveils that, this is an association merging the powers of European and American big banks (The Association for Financial Markets in Europe, n.d.-a).

It is obvious that this switch creates a decisive conflict of interest. Article 16 of EU Staff Regulation foresee to prevent conflicts of interest between old and new roles including the power to reject such moves (*Regulation No 31 (EEC), 11 (EAEC),* 2014). In such critical situations, the appointing authority has the right to forbid the switch. EBA could then oppose this change of job which might cause a conflict with the legitimate purpose of the organisation by a voting of Board of Supervisors. Yet, the chairman and the BoS gave the approval to this switch of job disregarding the conflict of interest. Although

they enforced some conditions on Farkas' subsequent position in AFME, the measures seem to be very ineffective (European Banking Authority, 2019f):

- *"Adam Farkas cannot engage in lobbying or advocacy of the EBA, or have professional contacts with EBA staff, for 24 months after leaving the Authority.*
- *Mr Farkas cannot advise his new organisation's members or otherwise contribute to the activities of his new organisation on topics directly linked to the work he carried out during his last three years of service for 18 months after leaving the EBA"*.

The main problem with this switch is not the direct lobbying of colleagues from Farkas but him transferring information, know-how, insider knowledge about procedures and networks to his future employer. In fact, this situation has a very high potential to reduce EBA's effectiveness, since Farkas would know all the possible ways to create loopholes in technical standards and guidelines; the creation of effective technical standards is EBA's main goal. Furthermore, the second condition of not advising on topics directly related to EBA's work can evidently not be monitored and controlled. Since AFME is an organisation specialised in banking including securitisation, capital markets union, equities capital market etc. (The Association for Financial Markets in Europe, n.d.-b) their future executive manager Farkas would not be able to participate in most of the proceedings and services if he would respect the second condition of EBA. Unfortunately, the letters from Joint Committee (EBA's Joint Committee, 2019) as well as Advisory Committee on Conflict of Interest (EBA's Advisory Committee on Conflict of Interest, 2019) show that the committees did not even consider blocking the move, although they acknowledged the conflict of interest between Farkas' current and future employment. Another letter from the Chairman Campa highlighted the freedom to choose an occupation and right to engage in work (*The Charter of Fundamental Rights of the European Union*, 2012) in order to justify the decision (J. M. Campa, 2019). It can be remarked that Campa's position to reject Farkas' move was very weak considering his own previous occupancy and the fact that he had to manage this dispute only two months after his commencement in the institution. In effect, Campa's own conflict of interest concerning his vested Santander shares were handled by the Board of Supervisors simultaneously with the Farkas' case and the final decision about chairman's conflict of interest was even taken after the result of Farkas' case (Swyngedouw, 2019). These events deeply harmed the reputation of the institution. Members of the European Parliament such as José Gusmão and Sven Giegold spoke harshly about the incidents while Gusmão quoted: "The decision to allow Farkas to move to a major financial lobby is a blow to EBA's credibility. If regulators don't take themselves seriously, how can they expect citizens to do so?" (Banks, 2020a)

Third, EBA nominated Gerry Cross, a former lobbyist who used to work for AFME as Farkas' replacement on January 2020 (European Banking Authority, 2020). It is worth

mentioning that, before his nomination, Cross was working for Central Bank of Ireland and he was also a member from Board of Supervisor in EBA. Still, his pre-public occupancy is characterised by lobbying organisations. Cross worked for IIF between September 2008 to May 2011 and for AFME as Head of Brussel Office between June 2011 and March 2015 (European Banking Authority, 2018a). Although IIF is listed just with two non-accredited lobbyists in EU Lobby Register in 2018 (LobbyFacts.eu, n.d.-b), the organisation is accepted as one of the most powerful institutions directing financial decisions on international level (Kalaitzake, 2017; Lall, 2012). To exemplify, the financial lobby success concerning the change of Basel III agreement on capital requirements for lending to SMEs that was documented by Keller (2018) and mentioned in section 2.2.1 on lobbying, was highly influenced by a report of IFF. In this document called "*Interim Report on the Cumulative Impact on the Global Economy on Proposed Changes in the Banking Regulatory Framework*", IIF claimed that the regulatory changes would cause a substantial credit decrease between 2011 and 2020 (The Institute of International Finance, 2010). This situation will result in a 4,4% lower GDP and 4,8 million job losses in Euro Area. Gerry Cross authored this report, among other participants. After this report European Commission tasked EBA to analyse the situation. Although EBA determined that the stability of smaller firms could be affected, the organisation did not back up the claims of such a tremendous GDP decrease. Also, The Basel Committee's own report prepared cooperatively with the Financial Stability Board found a GDP decrease of 0,38%, a percentage which is nothing closer to IIF's estimate (Lall, 2012). The financial lobby, unable to convince authorities with reports switched then to noisy politics aiming to directly influence SME owners and MEPs. European Parliament finally decided on lowering capital requirements contradicting EBA as well as the European Commission (Keller, 2018).

After his employment in IIF, Cross switched to AFME where he had a managing position as the Head of Brussel Office. The role and tasks of this lobbying organisation was already mentioned in the analysis of Farkas' case. When Cross appeared before the nominee of Economic and Monetary Affairs Committee in the European Parliament on 22 of January 2020, his candidacy was rejected by a narrow margin; 24 against 27 MEP votes. Since the appointment of the executive director must be confirmed by European Parliament according to EBA Regulation (*Regulation (EU) No 1093/2010,* 2010), a plenary session in the Parliament was necessary to approve the nomination. This time the rejection had a larger margin with 335 against to 272 in favour and 48 abstentions (Banks, 2020b). EBA must now identify another member to nominate for the position.

As it can be observed, all the decisions made by EBA were extremely unconsidered; starting from appointing a chairman from banking sector who possesses stock market shares from his previous role, continuing by not using its power to reject its former executive manager joining the biggest European lobby organisation and finally

nominating a member who has a 7,5 years lobbying past to be the new chief executive officer. These subsequent cases show that the phenomenon of revolving door did not occur on a single occasion but rather it is an influence mechanism jeopardizing the public institution's effectiveness and reputation. The revolving door cases of the EBA were equally documented by the NGO, Corporate Europe Observatory (Corporate Europe Observatory, n.d.-a). The organisation equally offers a provision called "the revolving door watch" documenting the practices of several senior ex-public employees (Corporate Europe Observatory, n.d.-b).

It is difficult to directly show how revolving door undermines the effectiveness of EBA, yet the investigation cease for Danske Bank's money laundering charges gives some clues. The bank acknowledged that 200 billion euros of suspicious transactions streamed through its Estonian branch between 2007 and 2015 (Bjerregaard & Kirchmaier, 2019). Afterwards, the national regulators of Denmark and Estonia publicly blamed each other, and EBA opened a formal investigation for a breach of EU law. However, the investigation was overruled after the voting by the Board of Supervisors on 16 April 2019 without issuing a recommendation. Although EBA admitted that both national authorities did crucial mistakes, nothing illegal took place. Both national authorities expressed their satisfaction with the decision (Gronholt-Pedersen, 2019). Unlike the national authorities, European Council voiced its discontent and said that "EBA undermined its own credibility" by this decision. EU Justice Commissioner stated: "The case of Danske Bank is not closed for us regardless of the decision of EBA. I will make sure that this case will not be swept under the carpet" (Bjerregaard & Kirchmaier, 2019, p. 27). Later, reports urged that the Central Bank of Russia warned both national supervisors in 2007 and 2013 informing that billion-dollar transactions were happening at the Estonian branch of Danske Bank (New Europe, 2019). In the article of Martin Banks (2020b), it is mentioned that the Danish government was happy with Gerry Cross' work and supported his nomination. Furthermore, Adam Farkas' deep insider knowledge of established technical standards and guidelines may be used to create legal loopholes by AFME. This situation directly jeopardises EBA's main goal of creating an effective European Single Rule Book in banking.

Dependency on National Authorities and Other Organisations

EBA's complicated hybrid structure involving ECB, European Commission and National Authorities is complicating the organisation's mission. A first strategic factor decreasing the autonomy of the EBA is the dependence of the organisation on national authorities. The organisation is incapable of performing most of its activities without the input of these authorities (J.-P. Salter, 2019). Indeed, the Board of Supervisors with voting power is constituted by 27 national authorities from each EU country. Also, 30,5 million from the total revenue of 50,5 million euros is provided by national authorities in the 2020 budget. Although national authorities are in accord with the EBA's and

Commission's goal of creating an integrated common financial market in Europe, they are equally a part of national markets and regulatory systems. In many occasions, national authorities were insisting in regulations and specificities suiting their market and regulatory context. For instance, an interviewed lobbyist affirms that they seek to influence Parliament and Commission to change the legislative scope of the regulatory issues, so that it fits better to their national context (Coen & Salter, 2020). Other interviews by the authors revealed that especially the two national regulatory authorities with a higher budget and long-dated expertise from England and Germany are more respected concerning policy knowledge than EBA, undermining the credibility of the institution. Moreover, the suspicion that the national authorities were influencing final decisions in meetings, contradicting public consultations, harms accountability, credibility as well as transparency. The money laundering scandal of Danske Bank gave a clear sign that EBA's governance structure may not be optimal to accomplish its mediation goals. The money laundering case started in Estonian branch of Danske Bank and interlocked Danish and Estonian authorities. Yet, the scandal was later extended to Germany, Austria, and Sweden as Deutsche Bank, Raiffeisen and Swedbank allegedly helped the transfer of illicit funds from Danske Bank. In 2018, EBA opened the case to control if the transactions were in accordance with EU laws then closed it in April 2019 without adopting any findings. The closing of the case by the voting of BoS undermined EBA's own draft report prepared for the case (Bjerregaard & Kirchmaier, 2019). The events showed that national authorities were reluctant to punish each other in this cross-border scandal. The existing governance structure revealed the institution's inability to take a tough stand. The accomplishment of multiple important goals appears to be obstructed: "investigating alleged incorrect or insufficient application of EU law by national authorities, taking decisions directed at individual competent authorities or financial institutions in emergency situations, mediating to resolve disagreements between competent authorities in cross-border situations, acting as an independent advisory body to the European Parliament, the Council or the Commission" (European Banking Authority, 2018b). Furthermore, other EU institutions' statements such as the Parliament, Council and Commission showed that their trust in EBA is decreased.

Furthermore, especially after the decision to create the Single Supervisory Mechanism, while giving ECB the power to supervise most important European banks, EBA's role started raising more questions. The limited intervention power is decreasing the organisation's supervisory authority. Already, when the organisation was founded in 2011, EBA was criticised to be functionally too narrow regarding its intended mission and too broad regarding its raison d'être considering its legal basis, the Article 114 TFEU (Fahey, 2011). In 2015, EBA's chairman Andrea Enria mentioned the institution's existential search before he became the second Chairman of SSM following Danièle Nouy in 2019. Moreover, the limited intervention power may harm

EBA’s reputation like in Danske Bank case because the institution has marginal power but full political accountability.

4.2.4 Solution Suggestions

Revolving Door

Possible solutions to avoid revolving door were already mentioned on the chapter on European Central Bank. They could have been all applied in the case of EBA, but they were not. First, the appointments are crucial for credibility and accountability of EBA. Since the chairman as well as the executive director is elected by the Board of Supervisors, they have an important duty to choose an appropriate candidate. The nomination of independent academics with consultancy experience appears to be a good solution, especially if the candidates are external. If an internal appointment of a national authority is pursued, a candidate without lobbying experience should not be difficult to identify. The lack of qualified candidates can simply not be an argument. Concerning switches from public to private sector, the Regulation on EU Staff (*Regulation No 31 (EEC), 11 (EAEC),* 2014) gives the Board of Supervisors the authority to reject harmful movements. They must be used in obvious cases; Farkas’ situation was definitely a good occasion to force this right. The prohibition to join a lobby organisation according to the Article 16 is not for an indefinite time, but only for one year. It is difficult to comprehend why the prohibition for a relatively short period was not implemented by the Board of Supervisors.

Furthermore, the Regulation on EU Staff gives the power to reject revolving door moves to the authority that appoints the personnel. This rule is particularly problematic for EBA because the appointments are done by BoS and BoS members can become senior executives. As they might want to keep the private sector a future option for themselves, they would be reluctant to enforce bans. This situation creates a system of self-policing. The solution for this situation is the establishment of an independent and transparent ethics committee (Silva, 2019). Such an entity can be created within an institution, but it is optimal to establish a central European authority. The same situation concerning self-policing also exist in European Commission and such a committee can be responsible for all EU institutions including agencies.

Dependency on National Authorities and Other Organisations

Since decisions are taken by the Board of Supervisors, the national authorities are vital for the functioning of EBA. A solution to decrease the dependency on national authorities could be that EBA is provided with its own policy-making resources. EBA could have independent decision makers similar to European Central Bank’s Executive Board. In ECB, decisions are taken by Governing Council with 6 votes from Executive Board and with 15 votes from governors of national central banks which adopted the

euro as their currency. IMF also suggested a revision of board composition and voting arrangements; first, at a minimum, the Chair to vote, second, members nominated on European basis instead of solely on national basis (International Monatery Fund, 2013). It is also possible to give the observing ECB member an additional vote. Moreover, the existence of the Stakeholder Group can surpass the solemn function of recommendation provision. If the group can have superior powers concerning decision-making, it would be a good way to introduce public opinion on policy making.

Furthermore, EBA's direct revenue from EU budget could be increased to create a revenue structure in which the contributions from national authorities and EU have the same amount. Coen and Salter (2020) states that EBA has problems regarding attracting qualified workers, staff turnover and response time for financial questions. EU budget increase can also help to overcome these challenges. Although a budget increase would be impeccable for any organisation, it is usually difficult. In 2015, EBA requested the Commission for a budget increase to perform its broad range of tasks but they underwent a 6,2% cut. The organisation then had to abandon some of the projected deliverables (Ferran, 2016).

This position pushes EBA to set more realistic goals and preferences. Ferran (2016, p. 292) suggests that EBA should place itself as a hub of "accumulated knowledge, understanding and expertise on best practices." While decreasing the reliance on its weak supervision and intervention powers, the organisation would concentrate on being a glue between the non-Eurozone countries and the states of Eurozone. Its board of supervisors including all EU countries is optimal for open conversation and cooperation. The voting rights characterised by double simple majority in which a majority of Eurozone and non-Eurozone countries must be reached, equally represent a culture of collaboration. In fact, EBA's voting structure was changed after the introduction of SSM. In order to facilitate being the connection point between Eurozone and non-Eurozone countries, the board of supervisors started taking decisions based on dual majority (Gortsos, 2016). ECB's board does not have a governance structure giving voting rights to non-Eurozone countries. Such a direction, in which EBA voluntarily renounce to exercise its supervision and intervention powers, would also help the organisation to move away from ECB's shadow. The recent event of Brexit may be decisive, since London is a big banking base which is not a part of EU anymore. As London was EBA's former location before Paris, the organisation can use its ties that were gathered during the 9 years of operation in this city. Due to its limited powers EBA was accused to be "toothless" (Ferran, 2016) or a "emperor without clothes" (Fahey, 2011). It seems that it is time for EBA to embrace its role as the right hand of the king.

4.3 External Auditing Sector

In this chapter, unlike the previous examples of European Central Bank and European Banking Authority, a whole sector will be analysed. A similar analysis was conducted for the sector of rating agencies by Lawrence Lessig in the book "*America, Compromised*" (2018). The mission of the sector will be given like in previous examples but instead of institutional analysis, the context of the sector will be analysed, and systemic and strategic influence factors will be identified. Since the research about the independence of auditing firms is very rich and the European Union implemented new safeguards to guarantee independence under the Regulation 537/2014 (*Regulation (EU) No. 537/2014*, 2014), the most important elements of this regulation will be contemplated. Therefore, this chapter will not be about choosing an auditing firm and investigating it under the scope of institutional corruption but a holistic analysis of an entire sector with its threats to independence and applied solutions.

4.3.1 Mission and Goals

The purpose of external auditing is to perform independent, objective, and qualitative accounting evaluations. Audit independence indicate "the ability of the external auditor to act with integrity and impartiality during his/her auditing functions" or "having an unbiased viewpoint while performing audit test, analysing the results and conforming the audit report (Herath & Pradier, 2018, p. 404) or more generally "separate from social context" (Patel & Psaros, 2000, p. 317). The quality is usually described as an auditor's capacity to notice a material misstatement and report it (DeAngelo, 1981b). This definition of the quality is also related to independence. The purpose of statutory auditors and audit firms is given by European Union in the Regulation 537/2014: "Statutory auditors and audit firms are entrusted by law to conduct statutory audits of public-interest entities with a view to enhancing the degree of confidence of the public in the annual and consolidated financial statements of such entities. The public-interest function of statutory audit means that a broad community of people and institutions rely on the quality of a statutory auditor's or an audit firm's work. Good audit quality contributes to the orderly functioning of markets by enhancing the integrity and efficiency of financial statements. Thus, statutory auditors fulfil a particularly important societal role" (*Regulation (EU) No. 537/2014*, 2014, p. 1). The regulation equally highlights the importance of trust and quality.

An objective evaluation is important as auditing has the goals/functions of:

- Monitoring the activities of managers
- Improving the information environment with reliable financial statements
- Offering a source of protection against corporate failures (Herath & Pradier, 2018).

Historically, auditing started to detect managers' actions in behalf of shareholders. During the late 1890s, auditors worked for shareholders and the purpose of the process was spotting material errors and fraud (Kandemir, 2016). Existent information asymmetries between managers and owners create a moral hazard threat. It is possible that managers seek to maximise their own benefit instead of shareholders' interest. Therefore, they prepare financial statements that are controlled by external auditors. The credibility of a financial statement is only viable when external auditing is independent and qualitative (Quick & Warming-Rasmussen, 2015). For instance, a part of managers' variable revenue comes from accounting-based performance measures. Another part arrives from finance-based performance measures like stock price. A misleading financial statement would directly or indirectly alter collected revenues (Dopuch et al., 2004).

Following the development of securities market, small investors wanted more information about the financial condition of the firms. Starting from the mid-1960s, auditors' job evolved from being a "detective" for shareholders to become a "certifier" confirming the reliability of financial statements (Kandemir, 2016; Jeppesen, 1998). Information asymmetries exist also between managers/owners and investors. Therefore, financial statements are vital for investors and they represent the fundament of investment decisions. If auditors are not viewed to be independent, financial statements are accepted to be more doubtful. Consequently, the risk level of investments increases causing investment aversion. If the investment is done, the cost of capital is higher than it should be since high risk premiums are demanded for riskier assets (Quick & Warming-Rasmussen, 2015). Reliable financial statements are equally important for creditors, depositors, suppliers, regulators and any other third parties using the information. For instance, small to medium-sized enterprises which do voluntary audits obtain lower interest rates than unaudited companies (Svanström, 2013). The financial statements provide vital information for governments concerning fraud, bankruptcies, bailouts, and other financial operations.

4.3.2 The Context of the Sector

The roots of the auditing reach the 19th century. In the wake of joint stock company developments in the UK, the first Companies Act of 1844 acknowledged voluntary auditing. The auditing became mandatory within the scope of the Companies Act of 1900 but no requirements for auditor qualification were mentioned. The auditors were chosen by shareholders (Kandemir, 2016). The process back then consisted of verifying vouchers for cash payment. By the mid-1960s, the auditing process started to change. The simple inspection of vouchers transformed into examination and assessment of internal systems in UK and USA. Later in the beginning of 1980s, risk models were being used by big firms and in the beginning of 1990s, these models became usual due to globalisation and grand-scale mergers of accounting firms

(Jeppesen, 1998). The business risk methodology underlined that the audit failures were mostly happening due to extensive operational risks and not fraud or error which are less common. The search for risk identification methods paved the way for consulting services (Kandemir, 2016). In 1989, huge mergers took place. Ernst & Whinney and Arthur Young merged into Ernst & Young, then Deloitte Haskins & Sells and Touche Ross joined to form another company called Deloitte & Touch (Minyard & Tabor, 1991). In 1997, Price Waterhouse and Coopers & Lybrand became PwC. These companies formed the Big 5 with KPMG and Arthur Andersen (Ferguson et al., 2002). The expression of Big 4 appeared with the ending of Arthur Andersen's auditing activities after Enron scandal. Also, during the 1990s the hefty price competition caused further modifications and auditing turned into value-added services aiming to enhance the performance of clients. First, Arthur Andersen & Co stated focusing on business processes, then KPMG mentioned that clients wanted to know the relevant risks, industry best practices and their according place in the sector. Ernst & Young referred to the expansion of their audit purpose, Deloitte & Touche to the reengineering of the audit approach (Jeppesen, 1998).

Corporate auditing misinformation which played an important role in the downfall of firms, increased the pressure from media, investors, and other stakeholders for an unbiased auditing. Especially, the case of Enron caused an outrage and sparked subsequent policy decisions. Arthur Anderson was criticised for approving Enron's many questionable transactions. For instance, Enron used an off-balance-sheet partner to repurchase a sold asset, avoiding the transaction to be classified as a visible loan on the sheets or failed on financial disclosure in many occasions, like not mentioning that 75% of third quarter earnings in 2001, was gained from stocks and not operations (M. S. Salter, 2010). In another case, Lehman Brothers, before the bankruptcy, "swapped risky fixed income assets for cash just before publishing quarterly results while promising to buy back the securities later" (M. S. Salter, 2012, p. 18). Thus, the company represented its financial condition better than it was, avoiding stock price decrease. Moreover, executives who reached their short-term results secured their bonuses. The bank's auditor Ernst & Young stated that such a manoeuvre was not against the accounting laws. Although no illegal action occurred, the auditing company helped its client to give misleading financial statements failing the mission of providing unbiased accounting evaluation. Once such failures come to surface, audit firms damage their reputation tremendously.

Although the biggest accounting scandals ending up in bankruptcy such as Enron and WorldCom happened in USA, Europe has its own take on the matter: Lernout & Houspie's market price manipulation in Belgium, Ahold's overstated earnings forecast in Netherlands, Parmalat in Italy, Yline in Austria, Philipp Holzmann and Comroad in Germany (Pott et al., 2009). In most recent examples, PwC was criticised for providing recruitment and remuneration services to the board members of Thomas Cook while

auditing the firm (Kinder, 2019). Even in football, Manchester City's accounting methods were rejected, causing the team's ban from European championships for the next two years (Conn, 2020).

Similar to the case of rating agencies, the auditing firms have a business model, in which they have to give objective judgements and "financial licenses" to their clients. Hired auditors can issue an unqualified audit report, a "clean sheet" agreeing with the management on financial situation of the firm. The other possibility is a qualified audit report due to misstatements or lack of necessary information to detect misstatements. The options after a qualified audit report are (1) a qualified opinion, when there are material misstatements but they are not vitally affecting the final financial statement, (2) an adverse opinion, when the material misstatements are pervasive for final statements and (3) a disclaimer of opinion, if the auditor is not provided with necessary financial information to issue the previous two opinions (Kandemir, 2016). In case of disagreement, the managers can adjust the financial statements or search for a more "agreeable" auditor (Dopuch et al., 2004). Since auditors are "selling licences" enabling their clients to continue their operations, there is a risk of moral hazard. If competing private firms operate in an environment with an ineffective regulatory oversight, the chance of moral hazard rises. Authorities have concerns that the incentives of client retention along with other factors can jeopardize the objectivity and quality of auditing.

The independence of auditing sector has a long history of analysis. International Federation of Accountants (IFAC) defines two types of independence: independence of mind and independence in appearance (IFAC, 2013). Independence of mind directly concerns auditors. It is defined as a "state of mind that permits the expression of a conclusion without being affected by influences that compromise professional judgment, thereby allowing an individual to act with integrity and exercise objectivity and professional scepticism" (IFAC, 2013, p. 44). Independence in appearance is characterised by avoidance of perceived improper dependence. Its definition is "avoidance of facts and circumstances that are so significant that a reasonable and informed third party would be likely to conclude, weighing all the specific facts and circumstances, that a firm's, or a member of the audit team's, integrity, objectivity or professional scepticism has been compromised" (IFAC, 2013, p. 44). Thus, an external statutory auditor should be independent in mind and appearance. The expressions independence in fact and independence in appearance are equally used in academia (Pott et al., 2009). Independence in fact refers to an auditor ability to detect a material misstatement and report it (DeAngelo, 1981b). The two-level evaluation of the independence creates a challenge to realise if the auditor failed to detect a misstatement or purposely did not report it after its identification. Furthermore, the research of independence in fact necessitates information which is publicly not available (Daniels & Booker, 2011). Independence in appearance is equally important because decisions of investors and loaners are directly affected by it. The

measurement of independence in appearance is also challenging since some measurement methods like bond ratings or percentage of loan approval by third parties are dependent on many factors (D. Campa & Donnelly, 2016). A more detailed classification of independence and its typical safeguards can be found in the analysis of Jeppesen (1998).

The notions of independence in mind and independence in appearance can be interesting for the theory of institutional corruption as well. Lessig's definition mentions effects of systemic or strategic influences as they weaken an institution's effectiveness and public trust. Factual and perceptual influences can both reduce effectiveness and trust. The previously mentioned experimental study of Kesselheim et al. (2012) on institutional corruption in pharmaceutical sector is a good example. The authors found out that funding of a drug by a pharmaceutical company affected doctors' trust considerably. In an experiment with hypothetical drugs and 503 physicians, the physicians' willingness of prescription for drugs funded by private companies were two times less than their acceptance of drugs funded by National Institutes of Health. Alone the existence of a possible conflict of interest changed doctors' perception of a drug even if the drug had a high methodological rigor.

IFAC identifies different types of threats on independence that might create a decrease in quality and objectivity: (IFAC, 2013; Sec.100.12):

- Familiarity threat: it can happen because of tight connection between auditor and customer. Costumer may seem very likeable to auditor and auditor's ability to judge the financial situation objectively may decline. This threat may also happen if there is a family member or a close friend in a relevant firm.
- Self-review threat: it is caused by an auditor who is auditing the financial condition of the firm while suggestions given by his own firm influence the financial condition. Auditor may lose objectivity ignoring bad results caused by previous recommendations. This threat has higher chances to occur if consulting directly influence final financial statements.
- Advocacy threat: this threat occurs when an auditing firm defends position of its client because the auditor is involved in an arisen situation concerning its client or it identifies with its client's cause. Such a situation can happen when a client has litigation issues or disputes with a third party.
- Self-interest threat: it happens if an auditing firm has an interest related to client. The most common form is having a financial interest since customer can be commercially very important for auditing firm. Auditor can risk its objectivity for client retention. In another example, if an auditing firm also offers consulting services, client's success contributes to auditor's prestige.

- Intimidation threat: it may occur if an auditor feels threatened by a relevant party like management. An actual or perceived threat of firing or replacement can cause altered results.

For example, Quick and Warming-Rasmussen (2015) identified that familiarity and self-interest threats have significantly negative impact on German investor's perception of independence. On the other hand, advocacy threat was not a considerable factor. Self-review threat only became important when the fee earned by non-audit services was high. Another detected threat that is not mentioned by IFAC is the accountability pressure (Koch et al., 2012). The authors documented in an experimental study that accountability pressure had a significant negative effect, especially on lower-rank auditors. They were less persistent on their decisions and had a higher willingness to avoid confrontation. Furthermore, it is possible that many of these threats occur simultaneously.

Some of the threats have similarities and connections with biases altering physicians decision-making in the previously mentioned Sah and Fuh-Berman (2013) study on institutional corruption. For instance, the consistency and commitment bias can lead to advocacy threat or the friendliness bias and the familiarity threat highlight the same problem. So, auditors might not be aware of some of these threats and they would not notice that their objectivity is compromised.

It is worth mentioning that cross-cultural differences influence accounting regulations. Stevenson (2002) analyses the differences between France, Italy and UK on accounting approach using Hofstede's (1984) cultural dimensions. For instance, France is the highest scoring country in Europe in power distance and has a high score in uncertainty avoidance; hence the country prefers written rules on independence. France is also very sensible regarding the importance of independence in appearance. Also, utilising Hofstede's foundation, Gray (1988) created four accounting value dimensions; professionalism/statutory control, uniformity/flexibility, conservatism /optimism and secrecy/transparency.

In order to reduce such threats, the European Union introduced three important safeguards with the Regulation 537/2014. These measures are mandatory audit firm rotation in every 10 years, prohibition of certain non-audit services to audit clients summarized under a blacklist and a limit (70%) on the non-prohibited non-audit services as well as a limit (15%) on total fee that can be received from a client. These new laws will be discussed in detail in the section 4.3.4.

4.3.3 Systemic and Strategic Influence Factors

Identified influence factors are:

- The competition level (Shockley, 1981)

- The extent of non-audit services (Pott et al., 2009)
- The size of the auditing firm (DeAngelo, 1981b)
- The size of audited firm (Svanström, 2013)
- The duration of the audit engagement (Pott et al., 2009)
- The type of client and contact partner (Koch et al., 2012)

The Competition Level

The matters concerning the competition level are related to the evolution of auditing sector since 1970s. Multinational expansion and rising competition pushed audit firms to merge, increase their profitability to stay competitive. This was only possible by gaining new clients and keeping the old ones. Moreover, the stagnation of audit business led the search for alternative income sources and non-audit services boomed (Pott et al., 2009).

The competition level is a difficult factor to change. A high level of competition might affect a firm’s objectivity as an audited company can choose another external auditor. Shockley (1981) found out that a high competition level is the most important factor influencing perceived auditor independence. On the other hand, a low level of competition is bad for many other reasons. In macro economy, policy interventions concerning alteration of competition has never been a subject that authorities agreed on. Nevertheless, one of the aims of the new European regulation on auditing (Regulation (EU) No 537/2014, 2014) is reducing the market concentration of Big 4. Especially, the rule on mandatory audit rotation would decrease market entry barriers for smaller companies (Horton et al., 2018).

The Extent of Non-Audit Services

When a firm provides audit and non-audit services to the same client, two contractual relationships prevail. The offer of non-audit services (NAS) by audit firms has been the subject of many researches since this situation can create conflicts of interest. It is thought that audit firms may sacrifice their auditing objectivity, for not losing clients from whom they earn important NAS sums. Conversely, opponents of this idea mention synergies gathered by working in multiple fields since further knowledge about audited firm can ameliorate the auditing quality (Dopuch et al., 2004). There are many additional services that auditing firms offer, such as appraisal services, actuarial services, bookkeeping, internal audit services, financial information design services, taxation services, legal advice (Herath & Pradier, 2018), human resource (HR) management, information system design and implementation or general management consulting (Pott et al., 2009). Many of these services are banned in the new regulation. All the prohibited services are mentioned in the section 4.3.4.

The regulation states that the banned provision of non-audit services is considered a threat to auditor independence. Yet, further information about the reasons are not given. IFAC Code of Ethics equally states that the existence of NAS can jeopardize auditing independence, plus advices the assessment of risks and their significance. Although the elimination of risks is desired, it is not possible to eradicate them completely (IFAC 2013; Sec. 290.158).

A first element that should be noted is the fact that the type of provided NAS is important as studies show that not all the services cause a negative effect. In the study of Meuwissen and Quick (2019), HR services, tax consulting and advice on financial control systems had all negative effects on perceived independence of auditors viewed by supervisory board members in Germany. HR services had the most significant effect; a surprising fact considering that tax consulting was illegal when the study was done.

Cultural differences are apparent on the provision of NAS. An experimental study, which was performed on final year accounting students in UK, Australia, Malaysia, and India gave varying results in each country. For instance, unlike in the other countries, the provision of NAS was not considered as an important dependence factor in India (Patel & Psaros, 2000). In the context of European Union, it can be observed that countries like France and Belgium introduced full bans on NAS while other countries like Sweden or Finland did not prohibited such services at all before the new regulation (Horton et al., 2018). Consequently, the blacklist on NAS in the new EU regulation on auditing did not cause substantial changes in some member countries but essential adjustments had to be done in the laws of others. In Table 1, the situation concerning non-audit services previous to Regulation 537/2014 is given for EU countries.

Also, diverse stakeholders have different opinions on perceived independence. Nevertheless, external users of financial records such as investors have usually a negative outlook on the promotion of non-audit services (Quick & Warming-Rasmussen, 2015).

In general, most of the studies do not find that NAS services jeopardise independence in fact (Pott et al., 2009). Yet, when clients paid audit fees which were below the expected level and high NAS fees, the independence in mind was compromised (D. Campa & Donnelly, 2016). Contrarily, the studies on independence on appearance find results mostly in the direction of negative NAS effects, and this fact cannot be ignored since company investments and credits are dependent on it (Pott et al., 2009).

An aspect that most of the researchers is overlooking is the nature of auditing itself. The previously mentioned changes during the 1990s, altered the auditing process. A closer look on Jeppesen's (1998) analysis of KPMG shows how the line between traditional auditing and management consulting eroded. The firm uses five key

principles on auditing: 1) Strategic analysis, 2) Business process analysis, 3) Risk assessment, 4) Business measurement, 5) Continuous improvement. It is clear that the auditing firm delivers information and advice to make business decisions. Such an approach was previously considered under the category of consulting. The distinction between auditing and consulting has evolved to provide the information for the success of the company directly (in consulting) or indirectly (in auditing). Yet, the difference between consulting and auditing is not just some technicalities, the difference is fundamental; the auditing is characterised by the absence of economic interest in the audited client. On the other hand, in case of consulting, the firm that does the consulting is interested in the consulted firm's success. Since the decisions are offered by the consultant, the future success of the client becomes the success of the consultant. This situation creates a mutuality of interest and raises the question; can the auditor, impartial from the existence of NAS, be independent at all?

Even the creation of pure audit firms was on the table at the beginning of conversation on audit reform. The European Commissioner for Internal Markets and Services, Michael Barnier demanded a total ban of NAS and the formation of audit-only firms (Jones, 2011). The main disadvantages of pure audit firms would be the lack of effectivity due to seasonal nature of auditing and the difficulty to attract highly qualified candidates. The workload of auditing firms peak at the end and the beginning of a year. Then, since consulting activities are considered appealing for high-potentials, pure audit firms would face problems of attracting such candidates (Ratzinger-Sakel & Schönberger, 2015).

The Size of the Auditing Firm

The size of the auditing firm can create problems since smaller firms are perceived to be more susceptible to pressure (Shockley, 1981). First, bigger firms have better resources. The chance is higher that their qualified employees have better interpersonal skills, resisting the urge to cope with the management if the standards are not met. The high qualification of auditors is important to overcome perceived accountability pressure. Koch et al. (2012) noticed that lower-rank auditors, when they feel under high accountability pressure, tend to give a positive opinion for the financial condition of the firm then higher-rank auditors. Moreover, bigger firms have a larger portfolio and they are therefore less dependent of certain clients. They can preserve their accounting standards without the fear of losing a client if a management demands a too aggressive accounting. (Herath & Pradier, 2018). A larger portfolio also means a bigger reputation to damage if scandals occur.

The Size of Audited Firm

In a research based on regression analysis of 420 private companies in Sweden, mostly small-to-medium sized enterprises, Svanström (2013) revealed that additional

services offered beside auditing did not have a negative influence on corresponding firms. Accounting support in the framework of NAS showed even positive effects on auditing quality. The reason for this can be that economic incentives risking moral hazard are lower when smaller firms are audited since they represent a less significant part of an auditor's portfolio. It is also possible that learning effects and knowledge spillover is better in SMEs. Through the help of additional services, auditors can get a good overview of the audited firm. Similar results were also retrieved in a study based on private firms in Norway (Hope & Langli, 2010). Although the risk of litigation in Norway is low and the loss of reputation by a misconduct would be less damaging due to small auditee size, the auditors' independence were not impaired.

The Duration of Audit Engagement

The duration of audit engagement is also referred as audit tenure. The concept of audit tenure is characterised by two durations: key audit partner tenure and audit firm tenure. An audited company can change its auditing firm or keep the firm but change the partner within the firm. Thus, the rotation can be external or internal. It is not uncommon that firm partnerships are very long. For example, before the implementation of mandatory audit firm rotation in every 10 years in the EU law, the average tenure rate for FTSE 100 companies in UK was 48 years (Kandemir, 2016). The loss of independence is feared when the duration of partnership is lengthy. The first reason of this fear is the familiarity threat declining auditors' ability to judge the financial situation objectively. Another reason is the creation of routines, in which auditors evaluate the financial situation influenced by past experiences. Fuelled by earned trust, auditors may overlook actual misstatements. Long periods of tenure can result in "complacency, lack of innovation, less rigorous audit procedures and a learned confidence in the client" (Shockley, 1981, p. 789). Third, auditing companies' preference gradually move towards retaining the client and augmenting profit. "Client specific rents" are easier to obtain with increasing audit tenure and they can create a higher dependency on a certain client (DeAngelo, 1981a).

On the other hand, shorter audit durations and constant rotation can equally create problems. According to the auditor expertise hypothesis, information asymmetries between a customer and an auditor decrease overtime, enabling auditor to acquire client-specific information. This knowledge facilitates the comparative evaluation, resulting in better quality audits (Pott et al., 2009). The learning of company specific account systems and internal controls is time consuming, and consequently the learning curve at the beginning of a new partnership is steep.

Pott et al. (2009) offer a review on audit tenure and rotation differentiating audit independence in fact and in appearance. The results from studies are not uniform, but mostly they do not find rotation beneficial. Yet, many studies investigated audit partner rotation instead of audit firm rotation due to lack of data. Furthermore, there were many

country-specific results; even varying results were found in different regions of Australia. The fact that European studies are in minority and mostly from UK obstruct the formation of an opinion on the matter.

The Type of Client and Contact Partner

It is possible that some clients prefer a more aggressive auditing type. Corresponding clients may also use the intimidation threat more often. Not only the type of client but also the contact partner within the firm causes different effects. Koch et al. (2012) found out that auditors' contact with an independent oversight board instead of a management board enhances the independence of auditors. Their experimental study showed that auditors with high client retention incentives have higher chances to accept management's favoured accounting method if they are directly hired by management board instead of a supervisory board. In order to avoid this situation, the 2006 Directive (*Directive 2006/43/EC*, 2006) already established that the companies qualified under the status of public-interest entities must have an audit committee. For instance, in German two-tier system, audit committee is chosen from independent members of supervisory board, whereas supervisory board members consist of representatives of shareholders and employees (Meuwissen & Quick, 2019).

4.3.4 Analysis of European Union Solutions

For a long time, cross-cultural differences abstained the European Union to legislate general rules on accounting. The European Commission's 8th Council Directive, implemented in 1984, delegated the power to national authorities. The purpose of this Directive was the harmonisation of rules and the early drafts looked strict. Nonetheless, UK negotiators exercised a strong power on the content of the final draft for flexibility, plus cross-cultural disparities caused authority delegation to national regulators (Stevenson, 2002). The revised 8th Directive became mandatory on June 2008 (Pott et al., 2009). The Directive 2006/43/EC was equally very flexible; without fee caps for audit and non-audit services, solely a requirement for key audit partner rotation within the firm and a vague condition for the provision of NAS which was interpreted differently by EU members. The heterogeneity of EU member state laws can be observed in Table 1. On October 2010, the European Commission unveiled a set of propositions under the document "*Green Paper on Audit Policy: Lessons from the Crisis*" (European Commission, 2010). After four years of intense negotiations and consultations the Directive 2014/56/EU was announced, and the Regulation 537/2014 was signed in April 2014. The Regulation became effective in June 2014. Compared with the older laws, the most important novelties were the mandatory audit firm rotation, the ban of many non-audit services summarized under a blacklist and corresponding fee caps for these NAS, and also a client related total fee cap for audit services. At the beginning, the European Commissioner for Internal Markets and Services, Michael

Barnier even demanded a total ban of NAS and pure audit firms, plus mandatory joint auditing alongside other requirements (Jones, 2011).

The main goals of the new regulation was reducing auditing firms' economic incentives for client retention, mitigating the risk of familiarity threat, and consequently ameliorating the independence of auditing firms. The other important objective was enhancing auditor choice, while reducing market entrance barriers and the dominance of Big 4. This measure was thought for decreasing the systemic risk in financial sector (Horton et al., 2018).

Although the Regulation was a milder version of the first draft, the content was still very controversial. A European compromise was very difficult to establish, since the national disparities concerning implemented changes were noticeable. In Table 1, it can be observed that there is no unanimity on the topics of firm rotation, NAS bans and fee caps. The closest EU countries approach to an accord is the topic of audit firm rotation, as every EU country except Italy and Netherlands do not support it. Yet, the Regulation decided conversely on prohibiting long tenures, setting a maximum limit of 10 years.

Table 1: Audit Regulatory Characteristics Before EU Regulation No. 537/2014 (retrieved from Horton et al., 2018)

Country	Audit Firm Rotation	Ban of Non-Audit Services	Total Fee Cap
Austria	Repealed	Partial	Yes
Belgium	No	Full	Yes
Czech Republic	Abandoned	No	No
Denmark	No	No	Yes
Finland	No	No	No
France	No	Full	No
Germany	No	Partial	Yes
Greece	Abandoned	No	No
Ireland	No	Partial	Yes
Italy	Yes	Partial	No
Netherlands	Yes	No	No
Poland	No	No	Yes
Portugal	No	Partial	No
Spain	Abandoned	No	No
Sweden	No	No	No
UK	No	Partial	Yes

It is worth mentioning that the regulation applies for public-interest entities. These entities are companies traded in European stock market, credit institutions and insurance companies, plus important companies designated by governments although they do not take part in stock market (*Directive 2013/34/EU*, 2013). Considering the previous research on SMEs and positive effects of NAS (Svanström, 2013), it is

plausible that the laws do not apply for smaller firms. Not to forget that, SMEs can loan with better conditions if they are audited. The specification also highlights the EU approach to reduce systemic risk in financial sector and avoid failing of large companies.

Mandatory Audit Firm Rotation

For the rotation external and internal possibilities are existent. An internal rotation permits the interchange of key audit partner within the firm. The Article 42 of the Directive 2006/43/EC obliged the rotation of key audit partner every 7 years without further specifications. Expanding the extent of the rotation, the Regulation 537/2014 implemented mandatory audit firm rotation. The maximum duration of audit firm partnership was set as 10 years plus 10 more additional years if a public tendering process is conducted or 14 additional years in case of joint audits. The cooling-off period is 4 years for the auditing firms; afterwards they are able to work with the same auditee.

Mandatory audit firm rotation is not a new idea. The procedure was already applied in Italy and Netherlands in Europe. Nevertheless, the other countries had to adjust their national laws. This rule was very controversial because even investors being the principal beneficiaries of new laws, were with 54% against the idea according to consultation results. Furthermore, according to a stock market response analysis, no significant positive or negative reaction was observed (Horton et al., 2018). The literature reviews of empirical studies on audit firm rotation equally do not support the concept. The costs related to rotation are accepted to be more than its benefits. The loss of firm specific knowledge and steep learning curve for new auditors are problematic, especially for big and complex audited companies.

For the comparison, the situation in USA is similar. Mandatory audit rotation is included in Sarbanes-Oxley Act of 2002, with a stricter maximum tenure limit of 5 years. Before the regulation, the American Institute of Certified Public Accountants (AICPA) analysed 400 cases of auditing failure between 1979 and 1991. The organisation concluded that the probability of audit failure was three times higher if an auditing was the first or second of an auditor. Also, a 2003 study of General Accounting Office showed that 99% of the 1000 largest public companies did not have a rule requiring mandatory rotation and they agreed that the costs of rotation would surpass its benefit. On the other hand, the Commission of Public Trust & Private Enterprise highlighted that a crisis in investor confidence has higher costs and therefore supported the idea of rotation to enhance confidence in auditors and in financial statements (Daniels & Booker, 2011). The abrupt policy changes were partly an outcome of the Enron collapse and resulting political expectancy for new legislation. Moreover, US environment is characterised by market-led investor protection approach.

The Blacklist for Non-Audit Services

Since extensive non-audit services can cause threats to auditor independence, the European Union decided specific bans of NAS. A blacklist is underlined in Article 5 of the Regulation (Regulation (EU) No 537/2014, 2014) prohibiting mentioned non-audit services, these services are:

1) tax services
2) management services
3) bookkeeping
4) payroll services
5) services of internal control systems or risk management
6) valuation services
7) legal services
8) internal auditing services
9) services related to the financing, capital structure, allocation, and investment strategy
10) services related to activities for company shares
11) human resources services

Moreover, sub-services for tax, legal and human resources services are given. Still, further specifications about the nature of these eleven prohibited services are not mentioned. A difference between this regulation and Sarbanes-Oxley Act is the fact that tax services are not prohibited in SOX (Ratzinger-Sakel & Schönberger, 2015). An additional safeguard to ensure the non-provision of NAS could be the specification of allowed NAS. Since many types of non-audit services are given, the types of allowed services, or at least some important examples would have created a better overview. According to Article 10, any other service can be provided after assessment of threats by public entity’s audit committee.

Table 1 shows that many EU countries had to adapt their auditing laws according to the blacklist. In France and Belgium, a full ban on NAS already existed. Countries with partial bans like UK already prohibited more or less all the services cited in blacklist (Ratzinger-Sakel & Schönberger, 2015). The changes will be more challenging for countries like Sweden or Finland which did not have mandatory audits, prohibited services or fee limits.

Fee Caps

Additional to the blacklist, a fee cap for non-audit services was written in Article 4. Furthermore, another fee cap limiting the revenues from a certain firm was given (Regulation (EU) No 537/2014, 2014). The fee from non-audit services cannot surpass 70% of audit fee. Moreover, the existence of a period during the three previous years, in which NAS was not provided would cause the annulment of the rule. The second

rule explains that the total fee, meaning the sum of audit and non-audit fee from a single firm cannot exceed 15% of an auditing firm's total yearly revenue. If an overflow happens, the situation must be disclosed and analysed by audit committee. The audit committee can decide for an additional quality control from another audit firm if the objectivity of the audit is doubted. Article 4 (3) also outlines that, even if the audit committee approves the overflow, the situation cannot exceed 2 years.

Remarkably, the proposed cap for non-audit services in the "*Proposal for a Regulation of the European Parliament and the Council on specific requirements regarding statutory audit of public-interest entities*" was 10% instead of 70%, representing a remarkable difference compared with the final law (European Council, 2011). The duration for audit engagements were also considerably shorter; 6 years or 9 years in case of joint auditing. The Big Four interpreted this proposal as an organized attack on them. They started a big lobby campaign as a senior EC member claimed that this lobbying was even worse than what he has seen with the banks (Horton et al., 2018).

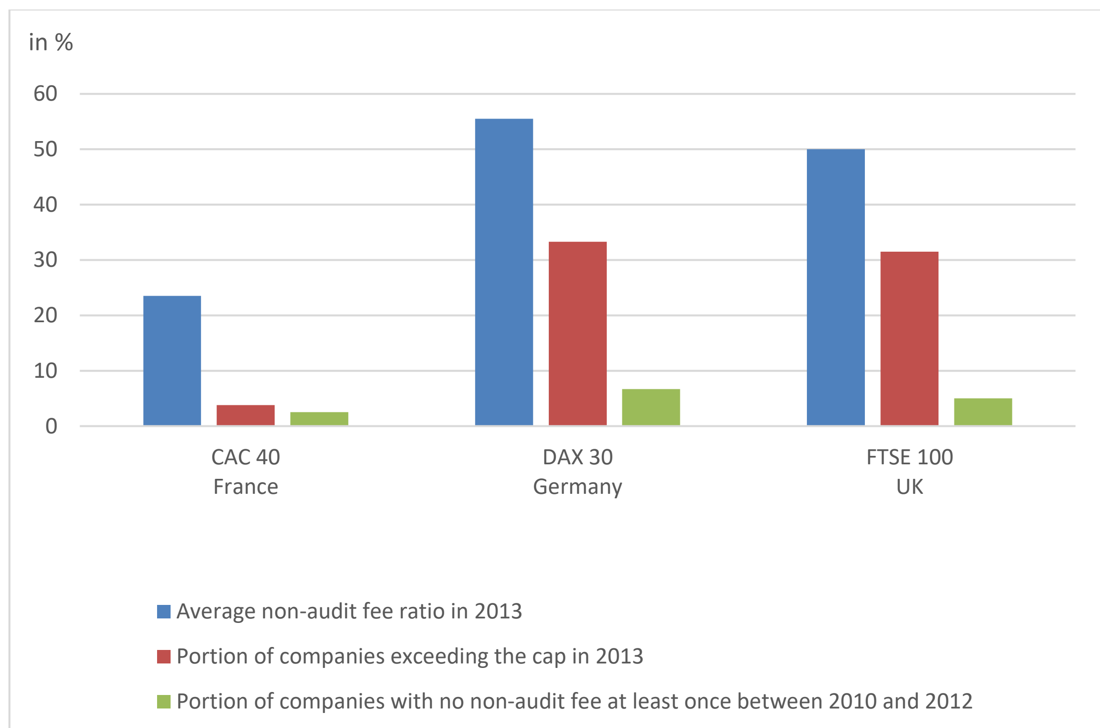

Figure 8: Auditor fees in France, Germany, and UK (retrieved from Ratzinger-Sakel & Schönberger, 2015)

The data of biggest stock exchange companies from France, Germany and UK indicates that the average fee ratio for audit to non-audit services is less than 55,5%. Furthermore, the percentage of companies which were exceeding the 70% limit were respectively 3,8% in France, 33,3% in Germany, and 31,5% in UK. It can also be observed that around 5% of the stock exchange companies had a time period without NAS services, causing the annulment of 70% fee cap rule, see Figure 8 (Ratzinger-Sakel & Schönberger, 2015).

Additional Remarks

Besides the three main changes, the extent of audit reports was expanded to deliver more information to relevant audit statement users. This step was important to close the expectation gap between auditors and relevant participants. However, the list of additional information to be included in report is lengthy. This amount of supplementary information described in 38 provisions with 9 clauses in the Regulation represent a large regulatory load for auditing firms (Kandemir, 2016).

The real clients of auditing firms are the users of financial statements. Although the auditing firms cooperate with management, the entities which are loaning money are the most concerned ones with the objectivity and quality of financial statements, consequently auditors' independence (Jeppesen, 1998). In that sense, it is understandable that the laws steer in the direction of money loaner protection. The European stock market analysis of Horton et al. (Horton et al., 2018) showed that the investors reacted significantly positive to changes. The aggregate market value was raised by 108, 63 million euros. Especially the firms with low earnings quality benefited from the new reform. Firms can equally use measures for increasing perceived independence for their own advantage. For instance, although the law on joint auditing was not implemented, companies could still choose to do it for attracting investors.

Not to forget that government officials are equally the users of financial statements. For instance, it is possible that government would have taken measures before Lehman Brothers' collapse, if officials knew about the true condition of the bank. On the other hand, it is possible that post-crisis policy responses can be over-reactions. For example, Bini Smaghi (2009) mentions that the drawbacks of Sarbanes-Oxley Act implemented after the Enron collapse are still enduring. Qualitative and quantitative analysis of national auditing laws do not show evidence that European national authorities failed to secure auditor independence (Ratzinger-Sakel & Schönberger, 2015). There is also no academic homogeneity concerning the matters of audit firm rotation and NAS prohibition. Moreover, ensuring auditor objectivity and reducing systemic risk through these measures can represent a trade-off between quality and independence. On the other hand, the final version of the law with 10+10, possible 20 years long auditing partnership is quite long. The 70% NAS fee cap and 15% total fee cap did not put a high pressure on most the auditing firms. Furthermore, the applied solutions demonstrate a political direction and a stand for independence.

Many other sectors in which institutional corruption is happening or feared can take valuable lessons from applied solutions in auditing sector. The concepts of independence in fact and independence in appearance are equally relevant for other domains like pharmaceutical sector as the physicians' trust can be threatened by

problems of independence in appearance. It is not enough that researchers are objective; their institution or the government should ensure that relevant stakeholders have confidence in the organisations. Considering the existence of biases and many experimental and empirical studies justifying their effects (Kahneman, 2012), additional safeguards to guarantee the independence are crucial. If the case of rating agencies is considered, some of the solutions of auditing sector can be interesting. For instance, carefully chosen fee caps can help to reduce dependence on big clients. The idea of joint auditing was not implemented in EU, but the concept of joint rating may be interesting, at least for financial products with very high valuation.

4.4 Deutsche Bank

Banks are vital actors in our economic system, directly and indirectly affecting public welfare. Deutsche Bank is one of the most important banks in Europe as well as in the world having a place in the "*Global Systemically Important Banks of Financial Stability Board*" (Financial Stability Board, 2019). Banks hold particular characteristics such as having information-based and opaque fundamental operations, capital structure founded on debt and a particular relationship with governments as implicit and explicit guarantees are provided (Srivastav & Hagendorff, 2016).

4.4.1 Mission and Goals

The main purpose and function of a bank was collecting money from people and institutions that possess savings and lend it with higher interest to other institutions (Baranes, 2009). Although this main function of gathering short-term liquid deposits and transforming them into long-term loans remained as the core activity, many different operations such as wealth management, credit card provision or creation of complicated financial instruments gradually appeared (Srivastav & Hagendorff, 2016). In a similar matter, Deutsche Bank was establish in 1870 to finance German foreign trade through national gathering of deposits and resulting loans (Müller & Hewetson, 1997). Today, Deutsche Bank as a universal bank, have many activities including commercial and investment banking, retail banking, transaction banking, provision of asset and wealth management products and services to private and public institutions (Deutsche Bank, 2019d).

The mission of Deutsche Bank is given as "to enable economic growth and societal progress by generating positive impact for our clients, our people, our investors, and our communities" (Deutsche Bank, 2019d, p. 6). The mentioned stakeholder groups in the non-financial report are clients, investors, employees, and the society. The relevant stakeholders can also be noticed in the purpose of the institution. It is worth mentioning that such a purpose including all these stakeholders is open to create conflicts of interest. Occasions that can cause a positive impact for one stakeholder while negative effects can be observed for another one may exist. The first time the mission was directly presented in the annual statement was in 1999: "Deutsche Bank is dedicated to being the best financial services provider in the world. We endeavour to make maximum use of our unique breadth of experience, capabilities and financial strength to create value for our customers, shareholders, employees and society as a whole" (Deutsche Bank, 1999, p. 2).

The values of the bank are integrity, sustainable performance, client centricity, innovation, discipline, and partnership. The letter from chairman of the management board highlights particularly the issue of sustainability as the letter starts with the

sentence “Sustainability is finally being given the status it deserves in economic life” (Deutsche Bank, 2019d, p. 3). These values are explained with more details in the website through adding beliefs related to them. For example, under integrity three beliefs are cited; (1) we live by the highest standards of integrity in everything we say and do, (2) we will do what is right - not just what is allowed (3) we communicate openly; we invite, provide and respect challenging views (Deutsche Bank, n.d.-a).

These values are present since 2013. In June 2012, while problems after the global financial crisis and the Eurozone crisis were continuing, a need for change in corporate culture appeared. For comparison, the mission in 2005 was stated as “we compete to be the leading global provider of financial solutions for demanding clients creating exceptional value for our shareholders and people”. The values were presented under the company slogan “a passion to perform” as the company pursues excellence, unique insights, innovative solutions and long-term relationships (Deutsche Bank, 2005). In 1999, similar to company vision, the core values were presented for the first time in the annual review and they were customer focus, teamwork, innovation, performance and trust (Deutsche Bank, 1999).

Table 2: Deutsche Bank's Values Between 1999 and 2020

	Values					
Time line						
2020 - 2012	Integrity	Sustainable performance	Client centricity	Innovation	Discipline	Partnership
2012 - 2005	Excellence	Unique insights	Innovative solutions	Long-term relationships		
2004 - 1999	Customer focus	Teamwork	Innovation	Performance	Trust	

4.4.2 Institutional Design

Deutsche Bank was founded by the politician Ludwig Bamberger and the banker Adelbert Delbrück in 1870 in Berlin. Delbrück was the first chairman of supervisory board, which had more extensive powers back then. Hermann Wallich who was an expert on international banking led the board of managing directors along with Georg von Siemens from the famous Siemens Family. The main reason of the bank’s establishment was financing German foreign trade. In the first 3 years, branches in Bremen, Hamburg, Shanghai, Yokohama, and London were opened. In 1876, with the acquisitions of Deutsche Union-Bank and Berliner Bank-Verein, Deutsche Bank turned

into the largest bank in Germany in terms of total assets. It was a universal bank with activities of bill exchanging and investment banking. After years of continuous expansion, the largest merger in German banking sector occurred. In 1929, Deutsche Bank and Disconto-Gesellschaft joined forces. During the rule of National Socialism, the activities of bank were mainly controlled by the state. After the end of Second World War, the bank was divided into ten different organisations with no legal status by Allies. In 1952, subsequent to following negotiations, three regional institutions emerged: Norddeutsche Bank AG, Süddeutsche Bank AG and Rheinisch-Westfälische Bank AG. After the repeal of the law "*Regulating the Regional Scope of Credit Institutions*", Deutsche Bank Aktiengesellschaft, listed in Frankfurt am Main was formed in 1957. Additional activities enriched Deutsche Bank's portfolio after 1960s. Retail banking with involvement of private customers boomed the amount of accounts. Starting from 1987, the businesses concerning house ownership, life insurance and home banking were introduced (Müller & Hewetson, 1997).

Today, the bank is active in many business sectors including commercial and investment banking, retail banking, transaction banking, provision of asset and wealth management products and services to private and public institutions. An important restructuring process occurred in July 2019 to enhance client centricity as the additional division "Corporate Bank" was created. Thereby the four divisions became: Investment Bank, Private Bank, Asset Management and Corporate Bank. The Corporate Bank includes former divisions of Transaction Bank and German commercial banking business (Deutsche Bank, 2019d). The activities of Corporate Bank consist of cash management, trade finance & lending, trust & agency services, and securities services. The focus is on treasurers and finance departments of corporates as well as commercial clients and finance institutions. Asset Management is done under DWS Group GmbH & Co. KGaA. The subsidiary manages active, passive, and alternative assets for individual and institutional clients. The Investment Bank blends Fixed Income & Currencies, Corporate Finance, as well as Deutsche Bank Research. It concentrates on financing, advisory, fixed income and currencies providing strategic advice to corporate clients. In the Private Bank, the retail banking in Germany is done through Postbank, plus there is another division for international clients. Wealth management is the third division (Deutsche Bank, 2019a).

Deutsche Bank's central is located in Frankfurt am Main and Germany has a two-tier corporate system (Meuwissen & Quick, 2019). Executive board has the responsibility of managing the company. The management board of Deutsche Bank has 9 members and they are responsible for strategic management, resource allocation, financial accounting and reporting, risk management, and corporate control. Christian Sewing is the chief executive officer, the president is Karl von Rohr. The supervisory board has 20 members and the chairman is Dr. Paul Achleitner. Supervisory boards comprise

two major groups: representatives of shareholders and employees (Meuwissen & Quick, 2019). There are members from various staff councils, shareholder representatives from different regions, the current and former Chairmen of Trade Union ver.di, the Federal Chairman of the German Association of Bank Employees (Deutscher Bankangestellten-Verband; DBV) and some independent members including former politician Sigmar Gabriel. There are also legal requirements for the composition of the supervisory board: at least 30% of the members must be women or men, the maximum age of participation is 70 and the tenure of membership should not surpass 15 years (Deutsche Bank, 2019d). The main duties of supervisory board are appointing, consulting, monitoring the executive board members. The supervisory board has 9 committees: Nomination, Audit, Chairman's, Risk, Compensation Control, Integrity, Strategy, Mediation and Technology, Data and Innovation Committee. Half of the committee members in each group is elected by employees (Deutsche Bank, 2019b).

4.4.3 Analysis within the Scope of Institutional Corruption

The case of Deutsche Bank is interesting because it fits Oliveira's (2014) organisational institutional corruption model very well. It is possible to observe problems in work breakdown structure, incentives, and communication. Regarding the incentive structure, the bonus culture of investment banking has always been a concern. Furthermore, there are many influences jeopardizing effectiveness of the bank, but the neglect of risk management will be analysed in detail. The neglect of risk management including compliance is also related to other factors such as tax avoidance strategies and financing of harmful practices that harm a bank's trust. It can be formulated that Deutsche Bank's granular goal of establishing and performing adequate risk management was not suitable to reach Deutsche Bank's purpose. Finally, Deutsche Bank had considerable communication problems with the employees who worked in acquired companies of Morgan Grenfell and Bankers Trust. The corporate and investment banking division appeared to play their own game, far from Headquarters as well as bank's core values. A broad analysis about the bank's evolution since 1995 concerning remuneration, risk management and communication will be contemplated.

Compensation Structure of Investment Bankers and Executives

Excessive risk-taking of financial institutions was a key reason of 2008 global crisis and the remuneration structure of investment bankers was considered to be one of the drivers of extreme risk-taking (Bebchuk & Spamann, 2009). Salter (2012) claims that short-termism is the main driver of institutional corruption in financial sector and the incentive structure of bankers plays a crucial role. Compensation in the financial sector is also a critical subject causing public displeasure because high levels of remuneration go as far as creating extreme wage inequalities. For instance, big bonus payments in

the financial sector were the main reason of wage inequality growth in UK. Bankers were responsible for 60% of the increased income share between 1998 and 2008 although they represent 5% of the total workforce (Bell & Van Reenen, 2010). The bonus culture of bankers caused especially a big public anger when Merrill Lynch gave annual bonuses after receiving governmental aid before its acquisition by Bank of America. In Europe, the paid bonuses in 2008 by French bank Natixis SA and Dresdner Bank in Germany pushed governments to react (K. J. Murphy, 2013).

The moral hazard of bankers is mainly caused by the lack of consequences if the investments or sold assets for clients give bad results. While clients may suffer big losses in future, the bankers as intermediaries could obtain instant remuneration from transactions. The asymmetry of risk is obvious as a banker would lose his/her job while clients may lose life savings. Even when banks use their own capital, this problem does not disappear as banks are mainly financed by debt capital (Bebchuk & Spamann, 2009).

Unlike many other jobs that offer a fixed compensation, variable compensation constitutes an important part of the total compensation in many banking divisions. For instance, a study encompassing Austrian, German and Swiss banks revealed that the share of the bonus is in average 23% for investment banking while it is 8% for retail banking department (Efing et al., 2015). The share of the variable pay is higher in USA since stock options are equally offered to middle managers. As bonuses represent a big part of income in finance, employees try to push them as far as possible, sometimes artificially. Bonuses were used to be paid in annual basis. Such an incentive structure paves the way for short-term investments that boost the annual salaries although they may create long-term risks and problems.

Compensation of top managers is also a prominent subject. Not only in finance sector but in every sector top executive pay rocketed between 1970 and 2000. Managers' pay became related to firm performance due to introduction of equities and stock options (Frydman & Jenter, 2010). The same situation is also valid in finance sector. Bank boards in USA reacted the deregulation of the sector by adding substantial option-based equities to encourage risk-taking of their CEOs (DeYoung et al., 2013). Multiple studies show that CEOs with option-based remuneration tend to take more risk, reducing banks' stability and default risks (Srivastav & Hagendorff, 2016). The fixed salaries of top executives are almost redundant, especially in USA. For instance, in 2006, the CEO of Citigroup, Charles Prince was paid a $1 million salary, a $13.2 million bonus, $10.633.333 in stock awards, $746.607 in option awards and $395.779 in other compensation constituting a sum of $ 26 million (Stempel, 2007). Before the global crisis, in 2007, the ratio of salary (including bonuses and excluding stock options) of executives to the average compensation per worker was 112:1 in USA, versus 82:1 in Germany and 55:1 in Australia (International Labour Organisation,

2008). Many researches concentrate on CEO and board compensation due to publicly available data coming from reporting requirements. Yet, in financial sector the remuneration of non-executive employees are equally important because they may take big risks. For example, in Deutsche Bank 2553 employees were identified as “Material Risk Takers” in 2019 (Deutsche Bank, 2019a). Efing et al. (2015) analysed non-executive incentive in investment banking and treasury/capital market departments in 67 Austrian, German, and Swiss banks. A correlation between incentive pay and bank risk-taking was revealed.

In Deutsche Bank, the rise of bonus culture and excessive remuneration started with the international expansion strategy of investment banking. The first stop was London as the heart of European investment banking. Deutsche Bank acquired Morgan Grenfell Group plc in 1989, then reorganised investment banking during 1994-1995 under the name Deutsche Morgan Grenfell (Müller & Hewetson, 1997). A top trader from Merrill Lynch, Edson Mitchell, along with 50 of his best traders were hired (Fichtner et al., 2016). One of the most prominent quotes of banking came from Deutsche Bank’s Head of Global Markets, Edson Mitchell: “if you don’t have $100 million by the time you’re 40, you are a failure” (Jenkins & Noonan, 2017). The quote showcases the kind of environment investment bankers were operating in. Since Deutsche Bank wanted to persuade employees from rivals to work for the bank, generous contracts were offered, and top traders were routinely earning more than $10 million annually (Jenkins & Noonan, 2017). There is not another industry domain which allows such financial revenues. The next step was the entrance in American market where banks were generating large profits. Since Deutsche Bank wanted to be a global player in investment banking, they expanded their operations to Wall Street. The bank was not well known on the other side of the Atlantic. It had problems of establishing itself and attracting talents at the beginning, thus with a similar strategy, they acquired one of the most important investment banks in Wall Street, Bankers Trust, in 1999 for $10 billion. At its peak, Deutsche Bank was the world’s biggest bank in the mid-2007 on total assets (Jenkins & Noonan, 2017).

Deutsche Bank had problems coping with Anglo-American way of doing business. It was even voiced that in Morgan Grenfell and Bankers Trust were reverse acquisitions in which Deutsche Bank had to follow their methods and behaviours without being able to transfer the bank’s own culture (Laabs, 2019). The fact that Deutsche Bank was between European and US American practices can be noticed by observing CEO salaries. The ratio of variable-to-fixed remuneration was in average 1,8 in Europe and 24,5 in USA for Global Systemically Important Banks (G-SIB) between 2006 and 2011, see Figure 9. As it can be noticed, the difference was colossal. The Deutsche Bank’s CEO Josef Ackermann’s variable income was for instance in 2007, eleven times higher than his fixed salary: lower than all the US Bank CEOs but higher than all the European Bank CEOs. Also, Ackermann’s absolute remuneration was considerable higher than

his European colleagues. No one was close to reaching his pre-crisis pay of around 14 million euros. The closest remuneration was obtained by his colleague in Bank of Scotland who earned about 11 million euros in 2007 (K. J. Murphy, 2013). The bail-out sum of Bank of Scotland was the biggest in Europe. The British Government infused 45,8 billion pounds to save the bank (Reuters, 2015).

	2006	2007	2008	2009	2010	2011
European Union						
Barclays	2.6	3.3	0.0	0.0	2.5	3.7
BBVA	1.6	1.8	2.0	1.8	1.8	1.5
BNP Paribus	2.6	2.5	0.0	1.5	1.8	1.4
Deutsche Bank	10.4	11.0	0.0	7.2	2.8	2.8
Groupe BPCE	0.8	0.2	0.2	0.0	0.0	0.6
Groupe Crédit Agricole	0.8	1.0	0.7	0.0	0.0	0.4
HSBC	1.6	0.9	0.0	3.7	2.4	3.6
ING Bank	3.1	2.7	0.0	0.0	0.9	0.0
Nordea	0.4	0.3	0.3	0.3	0.3	0.4
Royal Bank of Scotland	6.3	6.7	5.2	4.4	5.1	5.4
Santander	1.7	1.8	1.3	1.5	1.3	1.9
Standard Chartered	1.9	3.6	2.9	3.7	4.0	3.7
Société Générale	1.8	1.6	0.0	0.2	2.4	0.9
UniCredit	n/a	n/a	n/a	0.2	0.5	0.0
EU median	1.8	1.8	0.2	0.9	1.8	1.5
USAs						
Bank of America	14.1	12.5	4.8	0.0[a]	0.0	6.4
BNY-Mellon	12.0	18.3	10.7	9.9	18.0	19.1
Citigroup	23.6	24.3	38.9	0.0	0.0	7.9
Goldman Sachs	54.1	88.3	70.2	0.0	21.8	6.9
JPMorgan Chase	39.7	27.5	34.4	0.0	19.2	15.2
Morgan Stanley	50.6	50.2	0.0	0.0	17.6	15.2
State Street Corp	17.9	18.4	15.6	5.4	10.4	10.7
Wells Fargo	25.5	17.0	9.0	2.3	4.4	5.4
US Median	*24.5*	*21.4*	*13.2*	*0.0*	*14.0*	*9.3*

Figure 9: Ratio of variable-to-fixed remuneration for G-SIB CEOs between 2006 and 2011 (retrieved from Murphy, 2013)

There was a substantial decrease in bonuses after the appointment of the CEO, John Cryan in 2015. He quoted: “I have no idea why I was offered a contract with a bonus in it because I promise you I will not work any harder or any less hard in any year, in any day because someone is going to pay me more or less”, setting the tone for coming years (Jenkins & Noonan, 2017). One of the reasons of bonus decrease was in fact, the new Directive issued by European Union that introduced bonus limits (*Directive 2013/34/EU*, 2013). The ratio of variable-to-fixed pay was set as 1:1 or 2:1 under certain conditions. As a result, fixed salaries were raised to keep talented investment bankers and executives (Colonnello et al., 2018). Furthermore, at Deutsche Bank’s annual meeting in 2016, the shareholders surprisingly rejected the compensation

plans. The given reasons for the rejection were raised fixed compensations and the loss of 6,8 billion euros in 2015. Subsequently, the board decided to cancel their bonus payments along with substantial cuts for other employees (Shotter, 2016). As a matter of fact, Deutsche Bank paid 71 billion euros in bonuses between 1995 and 2006. Over the same period, shareholder earned 17 billion euros by owning Deutsche Bank shares. Although such a compensation sum was not unusual in the sector, its discrepancy compared with the income is remarkable (Jenkins & Noonan, 2017).

Another criticised aspect of compensation structure in Deutsche Bank was generous "golden parachutes". Between April 2018 and July 2019, Deutsche Bank paid 52 million euros for severances of dismissed senior executives including the CEO John Cryan (Storbeck, 2019a).

Neglect of Risk Management

The neglect of risk management was a crucial factor that lead to destabilisation of banking sector and consequently the entire economy during the global crisis. Failure of a bank, that acts as a web connecting many business activities have direct detrimental consequences on shareholders, bondholders, and taxpayers as well as many indirect effects concerning public welfare. Thus, reducing the risk-taking of banks attracted more and more attention.

Banks are open to three types of risk: (1) Default risk, where a bank cannot make payments on its debt obligations (2) Leverage risk, due to low levels of capital to sustain its operations (3) Portfolio risk, resulting from volatility of its asset revenues (Srivastav & Hagendorff, 2016). There are many methods to avoid risk, but organisational components of risk avoidance will be contemplated in this work, giving weight on governance issues. Optimal governance structures for banks may differ from governance structures in other sectors due to banks' role as a centrepiece in economies and resulting government guarantees involving taxpayers. The banking sector is characterised by risk-shifting problem, where shareholders' interest might not be aligned with creditors' and taxpayers' interest.

Three main organisational factors were identified in the review of Srivastav and Hagendorff (2016):

- The effectiveness of bank's board
- The risk management system and practices
- Compensation structure

The effectiveness of the board is a debated subject because countries have different legal requirements regarding company boards. For instance, while US American companies adopt a 1-tier system, where there is only one board, German law requires companies to have a management board, plus a supervisory board. Through an

analysis of the portfolio risk of German banks, Berger et al. (2014) found that executive boards with younger employees in average tend to take more risk while boards that have more members with a Ph.D. degree take less risks. Hau und Thum (2009) discovered that the competence of supervisory boards which is in function of education, management and finance experience positively affected bank performance in Germany during the 2008 crisis. The competence level was lower in public banks, obstructing effective monitoring of the management. It is difficult to say that Deutsche Bank as the biggest German bank suffered from supervisory board incompetence, at least concerning financial expertise and education level. Although Deutsche Bank suffered from big losses up to 5 billion euros in 2008, the bank was considered to be the apparent winner of the crisis compared with other banks. However, the bank's neglect of compliance and risk management caused many problems afterwards. The settlement for selling toxic assets which lead to housing crash amounted to a sum of $7,2 billion (Jenkins & Noonan, 2017). CEO's power can equally be influential on risk-taking. CEO's power can be observed through number of positions he/she holds, tenure or relative performance. For instance, Deutsche Bank's current CEO, Christian Sewing is also the chief of investment banking division. Josef Ackerman was considered to be a powerful CEO considering his relatively long tenure in Deutsche Bank between 2002 and 2012. Similarly, he was the CEO and chief of Corporate Investment Bank at the same time between 2007 and 2010 (Laabs, 2019).

Obviously, the well-functioning of risk management systems and practices are vital for controlling risk. The power of risk management can be measured through salaries of top risk employees relative to peers or the place of the risk manager in the company. Insider accounts showed that the banks in which risk managers did not have direct reporting possibility to the board were highly effected by 2008 crisis (McLean & Nocera, 2010). The power of chief risk officer (CRO) as well as qualification of members of risk committee are important factors. A particularity of Deutsche Bank was the fact that the headquarters were in Frankfurt while the biggest risks were taken in London and New York. Thus, the executive board ended up being far away from the places where a stronger control was needed. For instance, the headquarters of Corporate Investment Bank was in London and its most successful department was Money Market Desk in Global Finance and Foreign Exchange. One of the reasons of this success turned out to be manipulation of LIBOR rates. While such actions were happening, the Chief Risk Officer, Hugo Bänziger's office was in Frankfurt (Laabs, 2019). The resulting litigation from LIBOR resulted in an astonishing $2,5 billion fine for Deutsche Bank. Although other involved banks received similar penalties, Deutsche bank got an additional penalty due to non-cooperation with authorities (Jenkins & Noonan, 2017). Furthermore, the central risk management office did not have the expertise to evaluate many complicated financial instruments that were produced in London and USA (Fichtner et al., 2016). The manner how risk management is done can also vary. If the risk management is only done through a rigid compliance box ticking, it is less effective

(Srivastav & Hagendorff, 2016). Surely, compliance is the first prerequisite of risk management. Deutsche Bank suffered by multiple litigation cases and subsequent settlements and fines. The post-crisis fines added up to a massive sum of 9 billion euros (Jenkins & Noonan, 2017). Finally, the risk culture of a firm is very influential on establishment and effectiveness of risk management. Companies and managers that wanted to elevate the limits of risk taking, pushed the risk management to the side, coming to a point where risk officers were mobbed (McLean & Nocera, 2010). Similar behaviour was also observed in compliance management as they were seen as party spoilers in their firms (Kenny, 2014). Certainly, breaking the rules would be classified as fraud, and illegal occurrences are outside of the scope of institutional corruption. Nevertheless, there are many examples of legal fraud, in which compliance is used as a mean. Vague formulations are utilised to be in a grey area of compliance, so that companies would not be judged legally of wrongdoing (M. S. Salter, 2010). The risk culture was very dominant in Deutsch Bank over the last 25 years since the bank's entrance in global investment banking scene. The neglect of risk and compliance management was not a onetime occasion in Deutsche Bank, but it was spread over a long time. It started with the hiring of Edson Mitchell who was the epitome of risk-taking from Merrill Lynch which was known to be a risk-taking bank (Laabs, 2019). The result of lacking risk management and compliance was big profits during the growth years and setbacks ever since. Many insiders admit now that the success in boom-years was based on shaky financing and abusive conduct (Jenkins & Noonan, 2017).

The compensation structure of traders as well as CEOs and its effects on risk-taking was analysed in the previous section. The importance of compliance and risk management is evident concerning compensation because they are both control mechanisms if the given incentive structure drives employees to take extensive risks.

Concluding Remarks

How Deutsche Bank's institutional design problems concerning risk management and incentive structure affected the company are shown. According to Oliveira (2014), another problem that can lead to institutional corruption is communication problems. If a company cannot transmit its goals and values to its employees, they may work for the wrong goals. Acquisitions process of Morgan Grenfell and Bankers Trust revealed that Deutsche Bank could not transmit its values or did not try to. They were considered as reverse acquisitions in which Deutsche Bank had to follow their methods and behaviours without being able to transfer the bank's own culture (Laabs, 2019). First, as a new player in investment banking, Deutsche Bank gave many liberties to traders in order to lure them away from rivals. Second, as profits kept coming during the boom-years, investment bankers could dictate their wills and goals to the headquarters. For example, while Edson Mitchell was in London, he told Deutsche Bank that his team would leave if the bank would not get stronger in USA (Jenkins & Noonan, 2017).

Deutsche Bank bought then Bankers Trust. Since 1999 Deutsche Bank performs People’s Survey (available in Human Resource Reports) to assess opinions and commitment to culture. In the first survey in 2013, after the latest value changes, the level of familiarity with bank’s values was 69%. This percentage then increased to 82% in 2014 and to 93% in 2015, showing that a noticeable effort was done by the bank to establish the new values. From another perspective, Nadine Strauß (2015) analysed the responsiveness of German financial newspapers for Deutsche Bank’s cultural change from its announcement in June 2012 until January 2013. She stated that, the media was still sceptical, possibly due to the contrast created by litigation cases.

The communication of values is important, but it is also vital that a company chooses appropriate values according to their goals. The lack of certain values might cause problems. For instance, Ehrenhard and Fiorito (2018) discovered that the European banks that possessed societal values like respect, equality and solidarity were not confronted with scandals and fines of great magnitude. In Deutsche Bank’s case, integrity found its place only after big scandals, in 2012. Yet, integrity was in fact the most common value between the 25 biggest European banks, but they were still involved in multiple misconducts like money laundering, terrorism financing and rate manipulations. The newly added values of integrity, sustainable performance, and discipline show that Deutsche Bank was trying to go back to its basics. Discipline is usually associated with the German way of doing things. Sustainable performance highlights a turnaround from speculative profits to long-term goals.

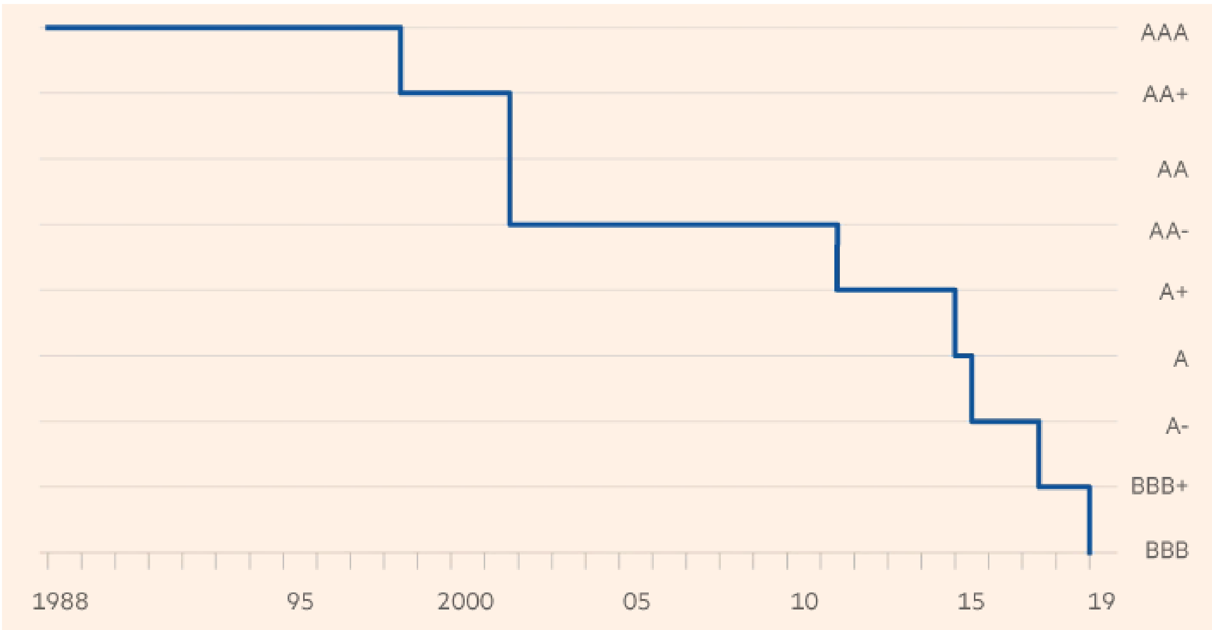

Figure 10: Fitch's Long-term Issuer Default Rating of Deutsche Bank (retrieved from Storbeck & Morris, 2019)

Here, a closer look can be given how effectiveness and trust were lost in last 25 years, since Deutsche Bank started its international expansion strategy in investment banking. The ambition to grow at any cost gradually decreased Deutsche Bank’s

stability. The figure 10 demonstrates how Deutsche Bank's rating downgraded step by step and this downgrading cancelled the bank's leverage advantage. One of the Deutsche Bank's advantages compared to its rivals was the bank's ease to receive credit with very good conditions due its high rating (Jenkins & Noonan, 2017).

Figure 11: Downfall of Deutsche Bank's Share Price in Euro (retrieved from Storbeck & Morris, 2019)

Furthermore, the downfall of Deutsche Bank's share price since 2008 accompanied by multiple CEO changes reveals how investors lost faith in the institution. As of April 2020, Deutsche Bank's share is worth less than 6 euros, far from its glory days. In Figure 11, it can be observed that Deutsche Bank managed to gather capital in critical moments. However, the patience of investors is consumed. For example, the vice-president of German Shareholders' Protection Association stated: "The shareholders I represent totally disapprove of the idea of yet another capital increase" (Storbeck & Morris, 2019). Consequently, Deutsche Bank enters a vicious cycle of decreasing revenue, high operational costs, a plummeting credit rating and the rising cost of financing. Since John Cryan's appointment in 2015, the bank tries to retrieve from investment banking and abandoned the dream of becoming the European rival of Goldman Sachs. This process is accelerated under Sewing's management and in 2019 the bank had to cut 18000 jobs to decrease operational costs, while shrinking the investment banking division. The public's perception of Deutsche Bank, which was always bit sceptical, worsened after big scandals (Laabs, 2019). In an interview with the Financial Times, an anonymous former German government minister admits the public disdain for speculative banking in the country: "Investment banks are like weapons producers or cigarette companies in societal terms" (Jenkins & Noonan, 2017).

All in all, Deutsche Bank disappointed all its stakeholders: clients, investors, employees, and the society. Clients by selling toxic assets, investors through bad management choices, unnecessary risks and consequent share price meltdown, employees by job losses and making them a part of an organisation with 7800 open litigation cases at its peak (Fichtner et al., 2016), society by involvements in rate manipulation or money laundering. "Deutsche Bank's journey, from a low-profit group focused on German clients and owned by German shareholders, to the epitome of global capitalism in the heady days before the financial crisis, is an extreme version of a path followed by many banks around the world. Its fate will hold lessons for lenders, governments and regulators as the banking industry continues its post-crisis evolution" (Jenkins & Noonan, 2017).

4.4.4 Solution Suggestions

Compensation of investment bankers

First actions to change incentive structures happened after the 2008 crisis under the Troubled Asset Relief Program (TARP) in USA. The organisations that received financial aid from the government were requested to eliminate compensation structures that cause redundant and extreme risks. Same obligations were also present in Section 956 of Dodd-Frank Act (K. J. Murphy, 2013). Furthermore, Basel III requirements were pointing at monitoring compensation structures and adapting them to adequate risk management (Bebchuk & Spamann, 2009).

The next step was the introduction of corporate governance reforms. When compensation structures are not optimal, a possible problem is usually the information asymmetry between insiders and shareholders. Therefore, it is usual to search for solutions through adjustments of corporate governance. Three measures were introduced to cope with this problem (Bebchuk & Spamann, 2009).

(1) Promoting the usage of restricted stocks
(2) "Say-on-pay" votes for shareholders
(3) Strengthening the role and independence of presidents (one-tier system) and supervisory boards and its committees (two-tier system)

Promoting the usage of restricted stocks ensures that employees cannot earn and sell their stocks before a certain period. Salter (2012) proposes using a five-to-seven-year period for assessing future growth since longer assessment periods would prevent short-termism. Longer terms of stocks vesting for high executives including risk-adjusted cost of capital would promote the realisation of long-term goals. Nevertheless, the vesting period was set as 3 years. For example, the current CEO of Citigroup, Michael Corbat had a salary of $24 million in 2018 including a long-term equity reward of $7,88 million vested for 3 years (Thomas, 2019). For comparison, Deutsche Bank's

Christian Sewing earned 7,1 million euros in 2018 with 3,4 million euros fixed salary and 3,7 million euros variable payment. 2,78 million from the variable payment was awarded as restricted equity which would vest for 5 years (Deutsche Bank, 2018). Restriction period of stocks is considerably longer in some other firms, especially in technology firms. For instance, CEO of Apple, Tim Cook did not receive the part of his salary based in stock options because his stocks must be vested for 10 years (Cao, 2018). “Say-on-pay” votes give shareholders more rights on deciding the pay of executives as backed by the Dodd-Frank Reform and Consumer Protection Act (Vallascas & Hagendorff, 2013). The policy is also present in Deutsche Bank as the shareholders have the last word. First, the Compensation Control Committee prepares and presents the compensation plan to the Supervisory Board, then the shareholders must approve the compensation plan in annual meeting (Deutsche Bank, 2019a). Deutsche Bank’s corporate governance report states: “Pursuant Section 25d (12) of the German Banking Act (KWG), at least one member of the Compensation Control Committee must have sufficient expertise and professional experience in the field of risk management and risk controlling, in particular, with regard to the mechanisms to align compensation systems to the company’s overall risk appetite and strategy and the bank’s capital base” (Deutsche Bank, 2019b, p. 18). The Compensation Control Committee has three members: Dr. Paul Achleitner (Chairman), Frank Bsirske, Detlef Polaschek and Paul Achleitner is given as the member who fulfils the condition of the German Banking Law. Frank Bsirke has been the chairman of trade union ver.di for 18 years between 2001 and 2019. Detlef Polaschek is an old employee of the company and had many different positions in Deutsche Bank. Additionally, the Risk Committee also examines if the bank’s remuneration structure reflects the company's risk, capital and liquidity condition (Deutsche Bank, 2019b). Nevertheless, adjustments of corporate governance alone cannot solve the problem of excessive risk-taking because similar to bankers, shareholders have also incentives to take more risk. The level of risk-taking that is acceptable for shareholders can have socially detrimental consequences. Such measures only ensure the benefits of shareholders while excluding interest of other stakeholders like bondholders, depositors, or taxpayers. Especially, in case of large banks categorized under “too-big-to-fail”, implicit government guarantees can cause shareholders to shift their risk to other stakeholders.

Governments should also implement measures to guarantee adequate risk management concerning compensation structures. The first measure would be monitoring of compensations and the second one changing legal characteristics of incentive structures. Regulators already have information about the debt situation of banks. They can demand the compensation details of top managers and calculate sensitivity of incentives. If the sensitivity is too asymmetric, they can request further guarantees like additional capital from banks. The other measure is doing direct structural changes on incentives in legal framework. Some suggestions are: replacing

equity-based compensation with compensation based on the value of securities representing a larger spectrum of assets, using accounting measures that represent the benefits of common shareholders such as return on equity or earning per common share (Bebchuk & Spamann, 2009). In general, using multiple criteria for personal and institutional performance appears to be healthier. The mere usage of stock performance neglect many different important criteria for an organisation's long-term performance such as research quality, innovation rate, customer retention or market share (M. S. Salter, 2012). The variable compensation of the management board in Deutsche Bank is based on many factors with different weighting factors, see Table 3. The short-term award has two components: the group component is based on important company values such as common equity tier 1 ratio, leverage ratio, adjusted non-interest expenses and return on equity, the individual component is based on individual objectives, balance scorecard and surprisingly discretion. The balance score card includes financial and non-financial measures such as personnel and innovation. The long-term award is founded on three factors including a qualitative measure, culture & client factor / control environment. The long-term award stipulates a three-year assessment period (Deutsche Bank, 2019a).

Table 3: The Elements of Management Board's Variable Compensation in Deutsche Bank (retrieved from Deutsche Bank, 2019a)

	Relevant Indicator	Relative Weight
Short-Term Award	Group Component	
	CET 1 ratio	25%
	Leverage ratio	25%
	Adjusted non-interest expenses	25%
	Post tax return on tangible equity (RoTE)	25%
	Individual Component	
	Individual objectives	60%
	Balanced scorecard	30%
	Discretion	10%
Long-Term Award	Relative total shareholder return	33,34%
	Organic capital growth	33,33%
	Culture & Clients factor / Control environment	33,33%

Increasing executives' personal wealth in the company may be a measure to decrease excessive risk-taking and institutional failure. For instance, compensation in the form of debt-like forms would transform bankers into unsecured bondholders interested in the liquidation value of the company (Vallascas & Hagendorff, 2013). In fact, multiple recent studies show that debt-based compensation has positive effects on the reduction of risk-taking (Srivastav & Hagendorff, 2016). Another measure is the introduction of claw-back option for bonuses. If some investments turn out to be unsustainable or unethically achieved, companies can request back the given bonuses (K. J. Murphy, 2013). For example, along the restructuring process under the new CEO, Christian Sewing, Deutsche Bank is trying to get rid of long-dated bad derivatives written in the boom years. The bonuses for these assets were collected long time ago (Storbeck & Morris, 2019). Another possible resolution is simply setting limits and leave the structural work to banks. This option was later chosen by European Union, along with clawback provisions.

After the crisis, Financial Stability Board (FSB) suggested specific measures to adjust banking bonuses in 2009: "(1) At least 40% of each executive's bonus would be deferred over a number of years, rising to 60% for the bonuses of the most senior executives. (2) The deferral period should be at least three years with at least half paid in the form of restricted shares rather than cash. (3) Cash payments should be subject to clawback provisions". German banks including Deutsche Bank accepted these suggestions voluntarily before introduction of a national or European law (K. J. Murphy, 2013, p. 643).

In 2013, European Union agreed on unified solutions across (*Directive 2013/34/EU*, 2013). An important adjustment made in this Directive was a remuneration cap. The chosen cap was not an absolute limit but a ratio: the ratio between variable income and fixed income was set as 1:1, it can be increased to 2:1 with acceptance by the supermajority of shareholders. Moreover, the clawback option was applicable up to 100% of variable income. The Directive was approved by a large majority in European Parliament with 608 MEPs in favour against 37 non-favourable votes. This regulation's intention was reducing risk-taking and possibly implicitly decreasing income inequalities, yet there was a worry that it may have some unintended consequences such as losing talented bankers, reducing Europe's competitiveness in banking sector and also contrary to the purpose, increasing risk-taking (K. J. Murphy, 2013). In fact, Europe did not lose talented executives as banks increased fixed pay to cope with the regulation. However, surprisingly the regulation did increase risk-taking. A possible explanation would be that bankers who were relatively risk-averse, took riskier decisions due to their increased fixed salary or less incentivised managers loosened up risk-monitoring (Colonnello et al., 2018).

Consistent with the new rules, fixed salaries were also increased in Deutsche Bank but in 2015 the management board willingly agreed not receiving bonus payments after a bad year. Next year, some bonus were planned to be distributed but at Deutsche Bank's annual meeting in 2016, the shareholders rejected the payment of additional bonuses. Subsequently, the board decided to cancel their bonus payments and cut other employees' bonuses by 80% (Shotter, 2016). After three years without variable compensation, Deutsche Bank's board decided to reintroduce the payment of bonuses in 2018 after reporting profit. In 2019, the board decided to receive their bonus despite a loss of 5 billion euros. The reason for this decision was attainment of important targets; the loss was caused by the restructuring process. The compensation plan was approved by shareholders (Storbeck, 2020). Yet, a cut of 22% from the bonus pool compared to 2018 still occurred (Deutsche Bank, 2019a).

Neglect of Risk Management

Concerning the board composition, for both executive board and supervisory board, educational background, finance, and management expertise are all crucial elements. Deutsche Bank's current CEO, Christian Sewing held multiple positions in risk department including Deputy Chief Risk Officer from 2012 to 2013. It appears to be a good choice to appoint a CEO with great risk management expertise and it also shares a message about the future of the company. Moreover, Stuart Lewis, the Chief Risk Officer is present in the management board and he is the longest serving member of the board since he became a member in June 2012. Considering that some high-ranked members like the chief regulatory officer, Sylvie Matherat, and the former CEO John Cryan were let go (Storbeck, 2019a), Stuart Lewis appears to have a power position with his long tenure. Moreover, due to Sylvie Matherat's departure in July 2019, he also took over the compliance function. Also, Deutsche Bank's president Karl von Rohr has extensive law knowledge due to previous positions and his university degree (Deutsche Bank, n.d.-b).

Deutsche Bank's supervisory board has a risk committee with 7 members: Mayree Carroll Clark (Chairperson), Dr. Paul Achleitner, Ludwig Blomeyer-Bartenstein, Jan Duscheck, Stephan Szukalski, Michele Trogni, and Professor Dr. Norbert Winkeljohann. The committee advises the Supervisory Board on risk strategy and screens the implementation of the indicated risk appetite and risk strategy by the executive management. Moreover, it examines if the bank's remuneration structure reflects the company's risk, capital and liquidity structure (Deutsche Bank, 2019b). The Chairwomen, Mayree Carroll Clark is the founder and managing partner of Eachwin Capital. Furthermore, the Integrity Committee and the Audit Committees support the tasks of the Risk Committee (Deutsche Bank, 2019a).

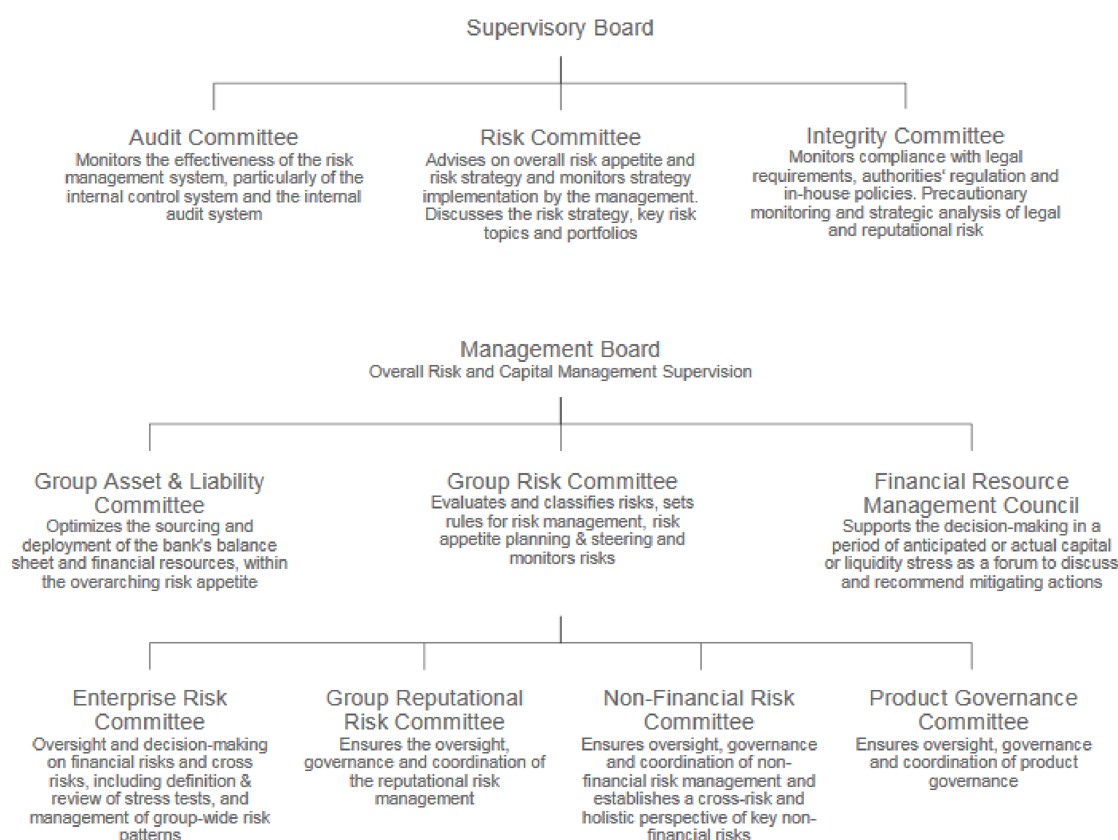

Figure 12: Deutsche Bank's Risk Governance (retrieved from Deutsche Bank, 2019a)

As previously mentioned, the risk culture plays a vital role on the effectiveness of risk management. After Ackermann's departure, Anshu Jain who was the head of Corporate and Investment Banking became the Co-CEO with Jürgen Fitschen in 2011, signalling that Deutsche Bank did not give up its ambitions in investment banking. In 2015, he was under great pressure after the 2,5 billion euros LIBOR rate rigging fine. The manipulations happened in London while he was the head of investment banking in the city. He had to resign as he was not supported by shareholders. Deutsche Bank gave then the sign of substantial culture change with the appointment of John Cryan. The first step was bonus cuts and plans to shrink unprofitable businesses. Furthermore, some activities that were contributing earnings but dubious on other grounds were shot down, like the Russian investment banking business. It was closed in 2015, after the detection of "mirror trades" allegedly utilized for money laundering. Since 2016, the staff in the anti-financial crime unit was tripled and €700 million was spent on modernising control functions (Storbeck, 2019b). One of the main reasons of employee increase was reducing the reliance on external expertise as money laundering, sanctions and embargoes are classifies as top risks (Deutsche Bank, 2019d). Although these changes indicate that the bank is steering in the direction of a better risk management, they also outline that risk and compliance departments were previously under financed. Moreover, methods like "job shadowing" where one

employee would follow another one for one day, are used so that people can become more familiar with risk and compliance management (Deutsche Bank, 2019c).

Risk-management is in fact a very broad subject. The details of Deutsche Bank's risk management are given in the bank's annual report (Deutsche Bank, 2019a). The bank has a framework for different risks and how it approaches them. The identified risks are: (1) Credit risk (2) Market risk (3) Operational risk (4) Liquidity risk (5) Business risk (6) Model risk and (7) Reputational risk. The risk management principles for these risks are given in detail. For example, one of the methods against extensive risk taking is the Three Lines of Defence; "the first line refers to those roles in the Bank whose activities generate risks, whether financial or non-financial, and who own and are accountable for the risks that are generated in their respective organizations, the second line refers to the roles in the Bank who facilitate the implementation of a sound risk management framework throughout the organization as risk type controllers, or for specific topics, as subject matter experts, the third line is Group Audit, which is accountable for providing independent and objective assurance on the effectiveness of 1st and 2nd line of defence interaction, risk management, internal controls and governance processes" (Deutsche Bank, 2019a, p. 55). Deutsche Bank's auditor is KPMG, one of the Big 4 of the auditing. There are also key numbers indicating the risk situation of the bank. Deutsche Bank conducts a conservative balance sheet management. The most important indicators are Common Equity Tier 1 (CET 1) capital ratio and fully loaded leverage ratio. Tier 1 refers to a bank's core capital; equity capital plus all non-debt long-term securities. It is compared with the total risk-weighted assets. The leverage ratio reveals the general relationship between debt and equity. As of 2019, they are in good levels in Deutsche Bank: CET 1 ratio is 13,6% at the same level of 2018 and leverage ratio is 4,2% higher than the set target of 4%. There is yet no legal obligation for the leverage ratio in EU law, on the other hand the required CET 1 ratio according to the fourth Capital Requirements Directive is 4,5% (*Directive 2013/36/EU*, 2013). The CET1 ratio mentioned by Deutsche Bank comprises the Pillar 1 minimum capital requirement of 4.5 %, the Pillar 2 requirement of 2.50 %, and the capital conservation buffer of 2.50 %. Consequently, the minimum ratio should be 9,5%. Furthermore, European Central Bank monitors the largest European banks through Single Supervisory Mechanism and sets customised limits for these banks. The given limit for Deutsche Bank by ECB in 2019 was 11,83%. Through amelioration of the risk condition the limit was lowered to 11,58% for 2020 (Deutsche Bank, 2019a, p. 60). Thus, the bank's CET1 ratio of 13,6% is still comfortably above the given limit. Deutsche Bank sets the targets of 2020 and 2020 for CET1 ratio at a minimum of 12,5%.

"I made a mistake in presuming that the self-interests of organizations, specifically banks and others, were such that they were best capable of protecting their own shareholders and their equity in the firms" declared Alan Greenspan after the 2008

crisis, highlighting that policy solutions are necessary (O'Brien, 2013b, p. 7). In such hyper competitive contexts policy solutions plays an important role. It is very difficult for a bank to do necessary risk reducing changes concerning capital requirements if other banks do not change their practices. There is high a chance that such a bank would lose competitiveness (Bini Smaghi, 2009). Consistent with this, many reforms took place all over the world. In international level, Basel II was updated to Basel III, strengthening the position of banks for risks. Dodd-Frank Act was introduced in USA and the regulation about capital requirements were equally changed in European Union under the fourth Capital Requirements Directive. In this directive CET 1 ratio was set at 4,5%, however the leverage ratio required by Basel III which was 3% was not applied. Although the Directive requires 4,5%, shareholders usually set slightly higher limits. Since large banks are vital to economy, European Central Bank was given further responsibilities under the entity of Single Supervisory Mechanism (*Council Regulation (EU) No 1024/2013*, 2013). As of March 2020, SSM monitors 115 largest European banks including Deutsche Bank (European Central Bank, 2020c).

5 Concluding Remarks

5.1 Discussion of the Results

Four case studies are analysed in this work, contributing to the understanding of institutional corruption in finance. European public organisations of European Central Bank and European Banking Authority, the whole sector of auditing and finally Deutsche Bank as one of the biggest European banks, are scrutinised within the scope of institutional corruption. Institutional corruption is a concept for gaining a better overview on organisations. The main purpose of the analysis is to reveal organisational blind spots and considering improvements so that these institutions can work better in the direction of their ascribed purpose and given granular goals.

For both public institutions of European Central Bank and European Banking Authority, the phenomenon of revolving door appears to be a problem. Yet, how European Central Bank manages the situation is better than European Banking Authority. While EBA recently suffered from revolving door cases concerning its top executives, ECB approached the situation more carefully, choosing five out of six executive board members with mainly public experience. This cautious approach was less visible in the past regarding the executive board appointments of ECB. Although a progress was made on the appointment of the candidates, the control mechanisms ensuring the departure of candidates with vital knowledge of these public institutions are very weak. For EBA employees, there is no strict cooling-off period. The only control mechanism is a possible ban on joining lobbying organisations, which is executed through voting of board members. This power was not used for the obvious case of the former executive director, Adam Farkas who joined the biggest European financial lobby, AFME. Cooling-off periods of six month to one year, exist for ECB, but they are very weak, especially compared with the cooling off periods of European Commission. According to their revised Code of Conduct in January 2018, the cooling-off period for former commissioners is increased from 1,5 years to 2 years and to 3 years for the President of Commission. This situation shows a need for unified cooling-off laws in the public finance domain encompassing both ECB and EBA. Moreover, ethic issues concerning departure of former employees should be arbitrated by independent and transparent ethics committees.

An influence that bothered the European Central Bank was membership and cooperation of executive board members to opaque organisations such as Institute of International Finance and Group of Thirty. The direct influence of Group of Thirty's agenda on ECB is difficult to establish since the content of this group's meeting are not published. Still, the European Ombudsman, Emily O'Reilly decided that ECB members

should not be a part of this organisation and this decision is respected in the current executive board. The influence of IIF which mainly represents the interests of the banking sector is documented by Kalaitzake (2017) during the European debt crisis or by Lall (2012) during the establishment of regulatory frameworks of Basel. The presence of IIF members such as Jean-Claude Trichet, Christian Noyer, Lorenzo Bini Smaghi and Jörg Asmussen in the ECB's executive board during the occurrence of these events exemplified an unhealthy relationship. In general, such memberships jeopardize transparency and accountability goals of the institution and these goals are very important for public organisations. In their paper about legal corruption, Kaufmann and Vicente (2011) found that accountability was the most important element, to reduce the effects of legal corruption.

A factor that was decreasing the effectiveness of European Banking Authority lies in its governance structure. EBA's decision-making body is constituted by 27 national EU authorities. Similar to ECB's governance structure, choosing additional voting members on European basis was proposed in 2017 to ensure effective, impartial and EU-oriented decisions, but it was not accepted by the EBA (Brunsden, 2019). The money laundering scandal of Danske Bank which involved multiple countries such as Estonia, Denmark, Germany, Austria and Sweden showed that national authorities were reluctant to punish each other (Bjerregaard & Kirchmaier, 2019). The existing governance structure revealed again the institution's inability to take a tough stand.

Since institutional corruption is caused by improper dependencies, the field of institutional independence is a very close domain to institutional corruption. If an organisation's independence is ameliorated, the effectiveness as well as trust in the institution would increase. This situation is particularly evident in auditors' independence. Auditors' purpose is to give objective and qualitative evaluation of firms' financial situation to avoid possible failures. They can only fulfil this purpose effectively if their independence is secured, especially within a business model in which they give operating licenses to their customers. In fact, the literature on auditors' independence is very rich, proving that institutional corruption is not a completely new concept. An important element that can be taken from the literature of auditor independence is the two different notions of independence: independence in fact and independence in appearance. It is not sufficient that auditors do their job with full integrity, but a proper context of independence should be noticeable by relevant stakeholders. The reciprocal relationship between effectiveness and trust should not be forgotten. The decrease of an institution's effectiveness might result in the decrease of trust, but this can work the other way around too. This premise is especially important in a sector such as finance that is based on trust due to information asymmetries. A simple example would be a bank that loses its investors' trust: the loss of trust may result in capital flight and capital flight would decrease bank's effectiveness. Thus, ultimately, independent from the fact

that the loss of trust is caused by factual or perception-based problems, the bank's effectiveness would decline.

In the fourth case study about Deutsche Bank, the institution gradually lost its effectiveness and the trust of all the relevant stakeholders: clients, shareholders, employees, and society. The international expansion strategy accompanied by neglectful risk and compliance management, exaggerated compensation structures and communication problems paved the way for the bank's downfall. Resultant of the high-risk strategy, Deutsche Bank's rating decreased gradually since the end of 1990s. Then, as the bank could not recover from the financial crisis of 2008 and the following scandals, the share price has fallen hitting historic lows nowadays. Consequently, the bank entered a vicious cycle of decreasing revenue, high operational costs, a plummeting credit rating and rising cost of financing. The reasons for Deutsche Bank's downfall and possible solutions for its resurrection are sought by multiple entities like its boards, shareholders, or relevant public institutions. The theory of institutional corruption founded on fulfilling the ascribed purpose may offer an interesting perspective.

The analysis of four different case studies exhibits that organisational solutions have potential to create other conflicts. For EBA, the introduction of a European-based executive board may solve mentioned governance problems, but it may also disrupt the current atmosphere of collaboration, in which all the national authorities have the same voting power. In another example, mandatory audit rotation appears to decrease effectiveness while increasing trust. Furthermore, internal organisational solutions may not be always adequate. For instance, aligning the incentive structure for the common interest of traders and shareholders is not sufficient, as shareholders may also have a risk appetite jeopardising public welfare. Policy solutions are necessary in hyper-competitive environments to ensure the preservation of the common good. Finding solutions for institutional design problems is at times difficult because there is not always a clear responsible for malfunctioning systems, and establishment of an effective solution may require multiple stakeholders to act.

Furthermore, the literature research on lobbying, revolving door, auditor independence revealed that Europe is considerably behind USA. One apparent reason is the usage of multiple languages in Europe. The research for French and German language articles showed that there are some additional works on the subjects, especially in French, for instance under "pantouflage" for revolving door. Another reason might be that capitalism and its effects are more obvious in the USA. Lobbying is more intense and prominent examples of revolving door occur more often, pushing researchers in these directions. Moreover, the spectacular bankruptcies of WorldCom and especially Enron, both audited by Arthur Anderson, attracted much attention in the auditing independence. The research on institutional corruption was done in the Edmond J.

Safra Research Lab in Harvard University. European examples on the subject, in or outside of the lab's Working Paper Series are rare. Unethical and untransparent lobbying, multiple occurrences of revolving door, failures due to auditor dependence and cases of institutional corruption certainly exist in Europe and more research should concentrate on these subjects. Finally, through the literature research, it was discovered that the term legal corruption was also in use. The concept of legal corruption already appeared in the European corruption report of Transparency International in 2011, while the term institutional corruption was not mentioned (Mulcahy, 2011).

This work strengthens the field of institutional corruption research through the analysis of four different case studies: two public institutions, one private company and a whole sector. One of the problems of the working papers published by Edmond J. Safra Research Lab was the presentation of institutional corruption cases without methodology. An important contribution of this work is its systematic approach on institutional corruption. The purpose and important goals are identified, then institutional design with its important elements such as financing, incentives and corporate governance as well as existent literature on the organisations are analysed to spot systemic and strategic influences, obstructing the fulfilment of goals and purpose of organisations. Moreover, ECB and EBA are vital European Union institutions, but organisational research on these organisations is not abundant, especially for EBA. The analysis of EBA within the scope of institutional corruption sheds light on the recent happenings from a different point of view.

5.2 Limitations

The biggest problem regarding the theory of institutional corruption is its conceptual ambiguity. Newhouse's (2013) attempt to limit the theory through the usage of fiduciary relationships was not welcomed by the community. The main reason behind the vagueness is the development and early extension of the concept for a specific institution: the US Congress. Afterwards, the efforts of applying the concept to different institutions such as private companies, think tanks or whole sectors produced understanding about problems affecting different domains but also raised questions about the precision of using the concept for other institutions.

The first papers on the concept of institutional corruption were theoretical or case studies. Moreover, the case studies were presented without a methodology contributing to the concept's vagueness. For that reason, the systematic approach is one of the benefits of this work. Yet, the used methodology has its own drawbacks. First, as it was mentioned previously in the section 2.3.2, many difficulties concerning the establishment of a purpose and granular goals are present. For public institutions of ECB and EBA, the purpose was directly stated in their regulations. The regulation

of the auditing sector equally provided a purpose for statutory auditors. For Deutsche Bank, the mission was given in the bank's annual non-financial report. Then, goals of institutions must be found and analysed. This task is difficult for big organisations with multiple goals. For instance, ECB has a very broad range of goals concerning monetary policy and banking supervision, while EBA's role is more limited. Moreover, as an outside analyst, it is not always possible to identify which granular goals are the most important ones. Thus, the level of institutional corruption in an organisation is challenging to establish. The fulfilment of the goals is analysed through examples in which they were not fulfilled. For example, the analysis of EBA's institutional design showed that the governance structure may obstruct the attainment of important granular goals but only after the closing of Danske Bank's money laundering case, the matter became more evident. Systemic and systematic influences are identified through literature research; hence it is possible that some influences are missed. Nevertheless, the main goal was finding the most important influences and their relationship with given granular goals. For instance, it is not conceivable to do a complete analysis of Deutsche Bank with all the influences and granular goals in a short case study, thus the concentration lies on inadequate risk management as a crucial factor obstructing the attainment of the bank's mission. A further limitation exists due to the work's nature as an interpretive qualitative study and the subjectivity of interpretations.

An important question is then raised; how flexible can the concept of institutional corruption be? Lessig (2018) states that the purpose of institutional corruption is to start a discussion within an institution. Its function is not retrospective but prospective and dynamic so that institutions can determine their future actions in a better manner. The idea of institutional corruption helps to identify extensive systemic problems that impair our lives directly by harming our health, wealth, juridical rights, and democracy. In fact, the concept succeeded to create a wide-reaching discussion in the political area. Important democratic candidates, Elisabeth Warren and Bernie Sanders, refused corporate donations for 2020 elections. Although their plans differ in some points in order to "get the big money out of politics", Warren, Sanders and Biden all promised a campaign funding reform (Evers-Hillstrom & Yu, 2019).

5.3 Suggestions for Future Research

For the advancement of the institutional corruption concept, empirical research with quantitative as well as qualitative studies should be done to analyse the effects of institutional corruption for institutions and society. For instance, Maciel and de Sousa (2018) show the effects of legal corruption using data from a EU Commission survey. Dincer and Johnston (2015) measure legal and illegal corruption in different states of USA. Furthermore, qualitative studies revealing knowledge of insider accounts are very useful. Only through such information, effective safeguards against institutional

corruption can be established. Gray's (2013) paper about the lobbyist Jack Abramoff uncovers his methods of lobbying and how he manipulated political decision-making using loopholes, while staying mostly in legal side. In the same spirit, Kenny (2014) gathered insider information from whistle blowers to show how compliance management was pushed aside in banking sector.

New methodologies can derive from the original concept of institutional corruption and be used in future studies. Oliveira's (2014) concept expressing institutional corruption as a problem of institutional design enables the usage of the notion in different contexts. Also, Brock and Russell (2015) offer a step-by-step methodology stemmed from Lessig's definition, additionally highlighting transparency and accountability requisites of institutions.

Light (2013) suggests a matrix assessing the extent, types and degrees of institutional corruption or corrupt behaviour. Benchmarks of institutional corruption can be developed as the degrees of dependence can vary. Some institutions are more "trapped", while others lean to a "self-induced" institutional corruption to gain wealth. After the scope and degree of corruption is identified, reactions of institutional members as well as dependency creators like money funders can be assessed. For instance, some pharmacy firms may create a self-induced institutional corruption through under-testing of side effects, under-reporting of them and aggressive promotion. On the other hand, rating agencies and auditing firms are leaning more to an entrapment due to their business model that does not have yet a viable alternative. If adequate control mechanisms are not implemented, they might lean into institutional corruption. Therefore, latest EU laws concerning auditing tenure, fee caps and banned not-audit services are important to safeguard the independence of auditors.

Moreover, the number of researches on the concepts of lobbying, revolving door and organisational independence is lower in Europe than in USA. The found results in US American context are not always applicable in Europe. For instance, in the rich field of auditor independence, most of the research is done in the USA, then comes the UK. Continental Europe should make a better effort to cover such fields.

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List of Abbreviations

AFME	Association for Financial Markets in Europe
AICPA	American Institute of Certified Public Accountants
AMLSC	Standing Committee on Anti-Money Laundering and Countering Terrorist Financing
BoS	Board of Supervisors
CEO	Chief Executive Officer
CET 1	Common Equity Tier 1
CRO	Chief Risk Officer
ECB	European Central Bank
EMU	European Monetary Union
ESCB	European System of Central Banks
etc.	et cetera
EU	European Union
FSB	Financial Stability Board
G30	The Group of Thirty
GDP	Gross Domestic Product
G-SIB	Global Systemically Important Banks
HR	Human Resources
IC	Institutional Corruption
IFAC	International Federation of Accountants
IIF	Institute of International Finance
IOSCO	International Organization of Securities Commissions
LDA	The Lobbying Disclosure Act
LIBOR	London Interbank Offered Rate
MAS	Monetary Authority of Singapore
MB	Management Board
NAS	Non-audit services
NGO	Non-Governmental Organisation
OECD	Organisation for Economic Co-operation and Development
ResCo	Resolution Committee
SEC	Securities and Exchange Commission
SMEs	Small to Medium-Sized Enterprises
SOX	Sarbanes-Oxley Act
SSM	Single supervisory mechanism

TARP	Troubled Asset Relief Program
TBTF	Too-big-to-fail
USA	United States of America