# *EXPLORING CORPORATE COMPLIANCE – NEW PERSPECTIVES ON HOW COMPANIES DEAL WITH REGULATORY REQUIREMENTS*

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**Abstract**

Arguing that a new perspective is needed to understand how companies deal with regulation, the study follows a constructivist approach to grounded theory as advocated by Charmaz (2006) in order to explore compliance behaviour. The setting of the study is the asset management industry in Germany and the UK. A series of in-depth interviews with members of an elite of senior experts in the field of compliance was used to generate the data that form the basis for this empirical enquiry.

The study includes a literature review, which presents an overview of all major schools of thought in the area of compliance-related research in general and with a specific focus on corporate compliance. While the literature review does not intend to develop any hypothesis, it illustrates different approaches that researchers in the field of corporate compliance have used: One group aims to understand what motivates compliance behaviour and another group aims to define what compliance behaviour actually means. These two approaches have informed the data analysis and have led to findings related to what motivates compliance behaviour and how compliance behaviour actually looks in regulated firms.

In particular, the study has enhanced the Nielsen-Parker Holistic Compliance Model, by introducing a new Holistic Model of Motivational Forces. This new model shows that economic and social motives are mainly external forces, while normative motives are important internal forces. Furthermore, it will be illustrated, which internal and external stakeholders are mainly influenced by the various forces.

In addition, the study opens "the black box of compliance behaviour" within asset management firms and provides a deep insight into how these companies deal with regulatory requirements. A commonly found compliance management system, which aims to overcome principal/agent-problems will be discussed and it will be argued that this system is prone to internal conflicts of interest.

Ultimately, the study provides a new perspective on compliance behaviour of regulated companies, which can help practitioners, regulators and policymakers to develop new and better ways to ensure compliance.

**Author´s Declaration**

I declare that the work in this thesis was carried out in accordance with the regulations of the University of Gloucestershire and is original except where indicated by specific reference in the text. No part of the thesis has been submitted as part of any other academic award. The thesis has not been presented to any other education institution in the United Kingdom or overseas.

Any views expressed in the thesis are those of the author and in no way represent those of the University.

Signed ……. Date 25.10.2020 …….

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# Chapter I – Introduction

*Father Brown laid down his cigar and said carefully, 'It isn´t that they can´t see the solution. It is that they can´t see the problem.*' (Chesterton, 1935)

Chesterton knew all too well that we all are easily convinced by a persuasive solution, even when we have never really bothered to understand the actual problem that needs to be solved.

This phenomenon can also be observed in the field of corporate compliance (i.e. the behaviours that companies show in connection with compliance to the laws). Companies within the financial services industry in particular are famous for producing newspaper headlines that feature poor compliance behaviour (e.g. "GAM Outlines Haywood´s Alleged Breaches From Gifts to Signatures" (Callanan & Winters, 2018) or "*BlackRock Hit With Record Fine by German Regulator BaFin*" (Henning, 2015)).

A common reaction by policymakers (and media alike) is to conclude that "weak laws" and lax legal punishment of wrongdoers are to blame. As a consequence, new laws and regulations governing the business activities of such companies are passed, whenever a new scandal makes it to the news. Many of the most recently enacted laws and regulation have become famous for the severe threats they impose by possible fines and other punishments for offending companies. For example, the European Market Abuse Regulation of 2016 introduced a maximum fine of 15 million Euro or up to 15% of a company´s annual turnover as possible punishment for market abuse or insider dealing. The European General Data Privacy Regulation from May 2018 threatens offending companies with a fine of up to 20 million Euro or up to 4% of the company´s annual turnover.

While such draconic punishment appears to be a logical reaction, it is really unclear whether this will have any effect on the actual compliance behaviour of companies. Reinhart and Rogoff (2009) critiqued that policymakers and regulators have continued to fail in preventing severe financial and even economic crises time after time. It appears that every financial crisis of the past century had its root cause in the fact that the financial services industry was especially innovative in the development

of new ways to manoeuvre around the existing laws and regulations in order to find new loopholes and generate profit. The threat of punishment has provided little help. The most recent "US sub-prime crises" is just another example: Banks developed smart new ideas to "hide" bad loans in complex financial products such as Credit Default Swaps, which enabled them to take huge risks on their balance sheet without being noticed by the regulator.

Of course, policymakers and regulators have followed up afterwards and have drafted new regulations illegalising such business practises (e.g. the "Dodd-Frank Act" as a direct response to the "US sub-prime crises"). It is, however, questionable, whether such a "rat race" between policymakers and companies can ever be won. What policymakers have often failed to ask during their endeavours to increase the threat of punishment and close any potential "loopholes" in the laws is, what corporate compliance actually looks like in reality.

Perhaps, prescriptive legal rules and the threat of severe punishment are not the right answers, because the underlying problem is not actually linked to insufficient legal rules or punishment. Maybe, it is time to change the perspective and try to seek out new ways to understand what can cause companies to break the law.

In reality little is known about what corporate compliance actually looks and how regulated companies build internal mechanism in order to comply with all relevant laws and regulations. Only a few researchers have ever made the effort to speak to compliance experts within these companies in order to open this "black box" and understand the multitude of internal and external stakeholders that can influence the compliance behaviour of a company.

The present study will contribute to closing this gap and will deliver new perspectives on how compliance behaviour in regulated companies looks and which stakeholders are relevant to determine the compliance behaviour.

The method used for the present study can be characterised as a form of constructivist approach to grounded theory, as advocated by Charmaz (2006). A series of in-depth interviews with members of an elite of senior industry experts have been recorded and then transcribed into text in order to identify codes in the data. The codes that were identified have then been developed further into larger codes and finally into theories. Methodologically, the aim of the present study is not to find new evidence for any given hypothesis (which would have been a deductive

process), but rather to develop new hypothesis, that lead to new theory (which was an explorative and inductive process).

The study includes an overview of the contemporary literature in the area of compliance related research. Different approaches to the topic of compliance behaviour are outlined and discussed. It is illustrated that some researchers have approached research in the field of compliance with a focus on the compliance behaviour of individual persons and others have aimed to understand how complex organisations, such as companies, act towards legal requirements. Furthermore, it is argued that researchers in the area of corporate compliance have developed their models from two different stand points: One group views compliance behaviour as endogenous to their research (aiming to study what "compliance" actually means) and another group treats compliance behaviour as exogenous to their research (aiming to understand causalities of "compliance"). Different models derived from both standpoints are presented and discussed. Although the present study is explorative in nature and aims to induct new knowledge out of data, these different models have informed the data analysis and are used to provide a "golden thread" throughout the development of a new perspective.

The empirical findings presented in the present study have ultimately led to the development of a new and enhanced model explaining what motivates compliance behaviour, as well as offering a new perspective on how compliance behaviour actually looks within these firms and how different internal and external stakeholders influence it.

# Chapter II - Literature Review

*You people at home cannot appreciate the exceeding value of Books. (Darwin, 1833)*

The above quote comes from a letter that the famous explorer, Charles Darwin, sent to his sister Catherine while he was on his excursion in South America on board of the H.M.S. Beagle. It reflects just how important books were for Darwin. It is estimated that Charles Darwin carried a library of around 300 books on his excursion on the H.M.S. Beagle and he still asked his sister to send him more (Pearn, 2014). Clearly, reading books was an important way for Darwin to learn the thoughts, experiences and perspectives of other fellow thinkers and explorers. Knowing the literature related to a certain field of study can be seen as both, a great source of inspiration and as a method for learning what is already known and what is unknown. The following section aims to describe how literature was reviewed in respect to the present study and which major themes have been identified as relevant.

## Epistemology and Purpose of This Literature Review

As will be laid out in more detail in Chapter III "Methodology" the present study uses interview data obtained in expert interviews. A constructivist approach to grounded theory was used to analyse and construct meaning from these data.

It should be mentioned at the outset that there is a conceptual conflict between a traditional literature review which aims to develop a theoretical framework comprising of research objectives and research questions (which is a deductive process) and doing grounded theory research (which is by nature an inductive process). This dilemma is shared by many researchers using grounded theory for a doctoral research study, where the performance of a classical literature review and the deduction of research questions is often a formal requirement (Stern, 2012).

For this background it is necessary to outline the epistemological stance from which this literature review was performed and which purpose it serves in the present study.

Glaser and Strauss (1967) had originally advocated to delay the literature review until the end of the study. This idea was supposedly driven by Glaser´s view that the researcher´s own preposition should be the standpoint of an "objective observer" in order not to influence the results of the research with his own ideas and to ensure that theory is "discovered" in the data.

Later Strauss changed his view and a debate about the place of the literature review in grounded theory began to surface. Strauss and Corbin (1990) disagreed with Glaser´s original idea and argued that theory should not merely be "discovered" but should rather "emerge" from the data and that hence the researcher should engage with the literature in all phases of the research.

Although, Glaser and Strauss were divided about the best use of the literature review in grounded theory they both agreed that the researcher should not interfere with the emergence or the discovery of a theory (Ramalho, Adams, Huggard, & Hoare, 2015). Consequently, both believed in the idea of an "objective" theory that can be discovered within the data.

Another school of thought challenges the assumption that the researcher can "detach" himself from the data and argues that every researcher enters the field with certain knowledge and constructs his own meaning from the data: Charmaz´s constructivist approach to grounded theory advocates that the researcher is "present in the research" and that the resulting theory is not merely something "discovered" in

the data, but rather something that was “constructed” by the researcher (Mills, Bonner, & Francis, 2006).

The present study is not based on an epistemological stance that assumes that conducting a literature review prior to data collection hinders the development of theory. As will be laid out in more detail in the chapter “Methodology”, the present study is based on a constructivist position towards grounded theory, as suggested by Charmaz. In doing research from this epistemological stance, it is assumed that the researcher´s influence on the development of theory is unavoidable. This epistemological stance therefore allowed the performance of a literature review prior to the actual fieldwork although grounded theory method was used for the research. The decision to perform a literature review in advance of the data collection was furthermore a formal requirement of the University in order to approve the research design proposal of the present study for the formal doctorate programme.

Nonetheless, it must be caveated that a constructivist grounded theory research is ultimately still an inductive approach, which prioritises (field-) data over other input. Consequently, Charmaz (2006) pointed out that the theoretical framework in grounded theory differs from other traditional research methods, as no pre-determined theories are deducted into hypotheses before data gathering. The literature review does not therefore aim to provide any such hypotheses. Instead, the grounded theory researcher should use the literature review “to provide an anchor for the reader” in order to demonstrate how the grounded theory refines, extends and challenges existent concepts (Charmaz, 2006).

The literature review presented on the following pages is therefore intended to provide a theoretical context for the empirical research and the grounded theory that will be presented.

Neither traditional research objectives nor detailed research questions will be developed at this point.

The present research study as a whole and the literature review in particular is guided by the abstract research question, what compliance behaviour in regulated firms actually looks and how it is motivated.

## Methodology Used for the Literature Review

In order to provide context for the later development of grounded theory out of interview data, this literature review aims to summarise the contemporary literature

regarding compliance theory in general, but also with a specific focus on corporate compliance.

One of the following two methods is typically used for the purpose of scientific literature reviews: The systematic literature review and the traditional narrative literature review.

The traditional narrative literature review was sometimes critiqued for being open to significant bias and systematic error (e.g. M. Hammersley (2002)). But as I will explain the narrative literature review method has some advantages over a systematic literature review in the context of the present study and was therefore used as a method of choice.

One advantage of the traditional narrative literature review can be seen in the arguably more effective literature search. This is to say that advocates of the systematic literature emphasise on the importance of identifying "each and every" written artefact that was produced on the researched topic. Rousseau, Manning, and Denyer (2008) have argued that "systematic" means that a literature review was performed comprehensively, with transparent analysis and reflective interpretation. The "comprehensive coverage of all literature" can only be achieved, if really "all" pieces of literature that could potentially be relevant to the research topic are identified, irrespectively of their publication date or quality. Only in a second step will the systematic literature review require the researcher to analyse the identified potentially relevant literature in more detail, taking into account the date of publications as well as quality. Hence, only at this point will the researcher begin to sort out the bits and pieces that are really relevant and that have contributed significantly to the area of interest.

In other words, a systematic literature review requires a "bottom-up" analysis of literature. By definition it also involves finding and reading of such parts of the literature that are actually of little or no relevance to the topic of interest.

Quite in contrast to this approach, a narrative literature review requires the researcher to analyse and synthesise the literature right from the beginning. The publication date is very important, and the researcher begins his work with a review of the most recent literature in his research area. He then conducts a systematic analysis of the various sub-concepts that lead to the development of the latest concept.

A narrative literature review is thus performed “top-down” and allows the researcher to focus exclusively on those pieces of literature that were really relevant for the topic of interest.
Furthermore, a comparison of the narrative and systematic literature methods presented by Mallet, Hagen-Zanker, Slater, and Duvendack (2012) suggests that a systematic literature review may not be as objective, as it may appear.
For example, systematic literature reviews are also not free of bias and can be prone to systematic errors. In particular, the idea that systematic errors or bias could influence the result of a narrative literature review more strongly, just because the researcher wrongly decides at an early stage, which part of the literature is deemed to be relevant, is questionable. Systematic error or bias can also occur during a systematic literature review.
The main difference seems to be, that a top-down oriented methodology (as used for a narrative literature review) may be more prone to bias and systematic error at an early stage of the review, while the same bias and systematic error can occur at a systematic literature review at a later stage. Either way, if a narrative or a systematic literature review method is used, ultimately the researcher needs to make the same decision: He must decide which parts of the literature are of significance and contribute to a specific theory and are therefore relevant (e.g. for the deduction of hypotheses and research questions) and which parts of the literature are only distantly related to the actual research or otherwise not relevant.
It is debatable whether the selected literature is less biased purely because this decision is made at an early or at a later stage of the review. In my opinion the researcher´s bias could influence the results equally in both methods. In fact, I even argue that the narrative literature review offers the advantage that any potential bias with regards to the selection and review of the relevant literature will be more obvious to the reader, as it might surface as a “gap” within the logic of the presented narrative. This informed the decision to choose a narrative literature review method for the present study.
Lastly, the narrative literature review allows the researcher to present his results in a chronological order. This often makes a narrative literature review more approachable, as it enables the reader to follow clearly each logical step clearly in the development of a new theory. This type of presentation helps the researcher, as well as the reader, to discover potential systematic errors or bias much more easily as this

would be possible for non-narrative result presentations, which is often used with systematic literature reviews.

Based on the sum of these considerations, it was ultimately concluded to use a traditional narrative literature review method.

Consequently, the following literature review presents a narrative view on compliance related literature and will provide an overview of all relevant compliance theories and will also evaluate the epistemological challenges affiliated with research in the area of corporate compliance in order to provide a context for the overall enquiry of the present study. All relevant theories will be presented as narratives, beginning with the oldest theory (i.e. the foundation of different schools of thought) and outlining the development of the modern theory.

In detail, the literature review will begin with a short introduction to the topic. The following sections will outline the three major compliance theories, as described in the literature (utilitarian theory, social theory and normative theory), as well as some less relevant compliance theories.

Furthermore, the literature review will provide an overview of the literature relating to the more specific area of corporate compliance. This part will illustrate the epistemological challenges affiliated with research in the area of corporate compliance and will present a process-oriented and a holistic theory of corporate compliance. The chapter concludes with a summary.

As stated above, the literature review does not aim to deduct any hypotheses or detailed research question from the literature. Instead, the aim and purpose of the literature review is to develop a “golden thread” that shall inform and guide the exploration of the present research topic.

## Introduction to Compliance as an Area of Academic Debate and Research

The term "compliance" refers to the adherence to rules in general and is used to describe law-confirming behaviour in particular. Research in the field of compliance is therefore directly related to the fundamental question, why do people obey rules? Consequently, understanding compliance requires us to draw concepts from an array of different disciplines, such as psychology, organisational and institutional theories, criminology and sociology (C. Parker & Nielsen, 2017).

Compliance research thus relates to some core concepts of social life: Ever, since historic times, when humans ended their nomadic life and decided to live together in communities, they established rules that govern and control their social lives. Since such times the question, why people should abide by rules, was of general significance and interest. The great Italian humanist Beccaria (1764) already approached this question, when he concluded that people choosing to live together in a society have to give up some of their freedom to the benefit of the society (e.g. share the space for living) in order to enjoy the advantages of living in a society (e.g. improved protection against wild animals or enemies).

Beccaria´s answer to the question why people should comply with rules, hence relates to a basic concept of morality, which means that people should respect one another and live peacefully together to enjoy the advantages of life in societies. Reciprocity seems to be the fundament for his basic concept of morality (i.e. I will let you hunt on my land, if you will allow me to cut the wood for the winter on your land).

This very basic concept of morality strongly influenced the thinking of modern scholars across different disciplines and still is equally important in today´s modern societies as it used to be during the times of Beccaria (Bessler, 2016).

In the 21th century societies have, however, changed and have become larger and more complex than they were during the times of Beccaria. The existence of a multitude of rules and laws are normal to us. We accept that various areas of everyday life are governed by rules, because we agree that these are designed to promote the advantages of living in a society. There are, for example, rules that determine how much tax a member of a society has to pay, rules on how to drive a car on a public street, rules that prohibit smoking in public places, etc.

We accept that these rules require individual members of the society to give up part of their personal freedom, because we understand that all these rules benefit the overall society.

Rules also found their way into more complex areas of social life, such as doing business or managing our financials. The complexity of our modern society and of these rules often makes it difficult to see the underlying reciprocities and it has become difficult to understand why someone should give up certain rights for the benefits of the wider society. At times it becomes challenging to see the reciprocity and morality behind specific rules. For example, how will the driver of a VW diesel-fuelled car benefit by the recently announced laws that prevent him from entering certain zones in big German cities?

This problem multiplies in complex industries such as the financial services industry. The financial markets function based on the idea of "fair trade". There are a variety of laws that govern, for example trading of stocks, which all aim to protect this basic integrity of the markets in order to ensure a "fair playing field" for all market participants. Unfortunately, not everyone is always willing to "play fair" and "by the rules" and as a consequence, there have been massive disruptions of these markets, which were often caused because the basic principles of morality and fairness were not followed.

Ultimately, these examples illustrate that to understand why people abide by rules in our modern world has not become less interesting or important today, than it was at the time of Beccaria.

Modern scholars have approached this challenge from different angles and across different academic disciplines, resulting in the development of multiple schools of thought. Most of these schools of thought have come up with independent models to explain compliance behaviour. Many of them have extended their models into the world of modern business.

The following narrative literature review provides an overview of these schools of thought, contrasts them against each other; and, in particular aims to illustrate how a scientific understanding of compliance behaviour has emerged.

## Utilitarian Compliance Theory

The medieval times are famous for their cruel punishments of offenders. These punishments were often used as a tool by the ruling elite to enforce compliance with their rules through sheer terror. One example of such cruel methods was the punishment by "cooking alive" that was imposed on murderers who had used poison for their crimes in medieval England (Kesselring, 2001). These rulers obviously had little concern for the question "why" people should abide by their laws and focussed their thinking on the question "how" can the law be enforced upon the people.

The only people who were interested in the question, "why" people comply with rules were legal scholars, philosophers and clerics. These scholars approached compliance mainly from a philosophical perspective and non-compliance was considered the result of the bad morals, bad character and personal guilt of the offender. Punishment was often related to the severity of the moral misbehaviour and was regarded as a way to "cure" an offender from his evil thoughts. Since medieval times Catholic priests would for example require wrongdoers to perform certain actions, such as to repeat certain prayers for multiple times, in the hope that their guilt could be forgiven by god and that consequently their "bad character" could be cured from guilt (Martinez-Pilkington, 2007).

Making a big jump into our modern times it is clear that the approach towards compliance research has changed a lot during the past 50 years. Suddenly, scholars with an economic background became interested in compliance related research. Soon, these new scholars identified economic reasons to explain compliance behaviour from a new and different perspective. Their interest was driven by the need to provide a new theoretical framework that could help to inform political decisions on how many resources should be used to enforce different kinds of regulations. Questions about resources and the costs of compliance had normally not bothered medieval rulers, legal scholars, Christian clerks or philosophers. However, as Bohanon (2012) suggested, good management of public resources had become increasingly important in modern western and democratic societies – especially post-World War II. With people becoming more educated and having democratic voting power, questions about the proper use of these public resources became naturally more important and had to be answered by politicians and academia, alike. Economists therefore ventured into compliance research from a completely new perspective and with the aim of understanding how a state could ensure compliance

with the law from a resource and cost perspective rather than a moral or philosophical view.

Resources in this respect refer to the number of policemen on the street, but also the costs for punishment (e.g. the costs to operate a prison). On the grounds of rational choice and utility maximisation a new economic theory of compliance was finally developed:

It was conceptualised that an individual would then break the law, if the expected utility to him exceeded the utility he could achieve from compliance (Becker, 1966). Vice versa an individual would obey a rule, if this behaviour would maximise his utility (e.g. if a penalty could be avoided). Based on this new thinking, a utilitarian compliance model – a rational choice theory - had emerged.

This model was (and in many regards still is today) appealing to politicians as it suggests that unlawful behaviour can be controlled by either increasing the costs of non-compliance (i.e. enhanced punishment and sanctions) or by increasing the control (i.e. more policemen on the street). Noting that the latter is much more expensive than the former, many scholars picked up this idea and focussed on the aspect of "deterrence" through sanctions (one notable piece of research in this area is for example "the sentencing project" by Wright (2010) or more recently and with a focus on deterrence by negative reputation the paper published by Sampath, Gardberg, and Rahman (2018)). A new deterrence model evolved as a sub-model of the broader utilitarian compliance theory.

There are however two important problems with all compliance models that ground on the assumptions of rational choice and utility maximisation:

Firstly, there is an important ethical problem involved in this kind of thinking: Using the cost of non-compliance to control compliance behaviour implies the assumption that an action can be considered to be morally right, if it would produce the greatest possible balance of good over evil. For example, to impose the death penalty on anyone caught dealing illegal drugs, as recently announced by the Philippines president, Mr. Duterte (Syjuco, 2017), would create the highest possible cost for breaking the law. In this scenario people would only engage in drug dealing, if there was a good chance that they could not be caught and convicted. If they were caught and convicted, it wouldn´t matter how much profit they would have made by their illegal conduct, as they would have to "pay with their life".

Such reasoning was labelled a "consequentialist approach" by Reynolds (1979). In a consequentialist approach, the consequences of an action justify their outcome (Israel, 2015). Therefore, from a utilitarian perspective, if the execution of drug dealers could be expected to increase the costs of unlawful behaviour and thereby enhance compliance with the law in general, such drastic punishment can be ethically justified.

This line of reasoning ignores, however, the fact that a milder punishment (or the more costly increase of control) might often lead to the same consequence. Consequentialist ethic was therefore rightfully critiqued for the fact that it is difficult to evaluate the consequences of every act all time and for every person (Sinnot-Armstrong, 2003).

The second problem with a utilitarian compliance theory is that it grounds on the assumption of rational thought. How much rational thought is really involved in unlawful behaviour? A special report published by the Bureau of Justice in the US had shown that half of prisoners in the USA had committed their offence under the influence of drugs or alcohol (Christopher, 1999). But even besides drugs and alcohol there are many more influential factors that determine human behaviour well beyond what can be seen as "rational choice" (Tversky & Kahnemann, 1986). Consequently, the assumption of "rational choice" seems rather inappropriate to ground a theory of compliance behaviour on.

Although the rationale choice theory of compliance is still applied by many government authorities around the world to this day, the critiques of a purely utilitarian compliance theory led to the development of alternative theories.

## Social Compliance Theory

Another school of thought was led by a group of sociologists in an attempt to move beyond mere economic reasoning and in order to approach the question "why do people obey the law?" from a sociological perspective. These scholars observed that the rational choice model of compliance failed to explain certain real-life observations. For example Murphy (2005) observed in the context of tax law compliance that the chances of getting caught and the benefits of non-compliance would actually suggest that non-compliance should be the rational choice. Despite this most people do not cheat. Scholars of this school of thought have argued that an individual´s acceptance of a rule depends largely on social motivations. Factors such as group pressure and the goal of social acceptance are relevant determinants for compliance behaviour (e.g. Brunner and Ostermaier (2019), Grasmick and Green (1980), Meier and Johnson (1977)).

Regulators such as the FCA begin to see that social groups (including professional groups such as the financial services industry) develop their own norms, values and practises, which may be labelled as "culture" and which have a strong influence on their compliance behaviour (FCA, 2018). Filabi (2018) has thus suggested that modern regulators should not stick with the old ideas of deterrence and rational choice and should instead begin to consider how they can influence "culture" in order to foster better compliance behaviour. In practice it is, however, quite difficult for regulators to regulate culture. One problem that they face is the fact that there is no "one size fits all" culture that can serve as a reference. Another challenge is that "culture" is something internal to a company or an industry. As Cottrell (2018) has put it, culture relates to "what we do, when no one is looking" and is strongly influenced by the leaders of a company or an industry. It is hence not surprising that regulators thus began to focus on regulating the behaviour of senior leaders within companies in order to influence the culture of a firm or industry indirectly. The FCA´s new *Senior Managers and Certification Regime,* for example aims to bind leaders of firms in the financial services industry to 5 Conduct Rules developed by the FCA in order to provide a broad framework for "a good culture" in the financial services industries.

Another method that regulators are increasingly looking into in order to foster a "good culture" in the industry was explored by Braithwaite and Drahos (2002) under the heading "naming and shaming". The theory behind this method is the idea of

creating social pressure to thereby foster better compliance behaviour among individuals as well as organisations. While a “shaming theory” seems to fall into the category of social compliance models, Harris (2017) later concluded that shame is normally felt, if an individual questions whether he has violated his own (normative) values. It is in fact often difficult to distinguish clearly between value-driven (“normative”) and other social-driven compliance motivations (e.g. group pressure). Losoncz (2017) was right to note that some elements of how people react to regulation (that is comply, ignore or violate) exist objectively, while other elements are intrinsically related to people´s personal cultural and historical backgrounds and are much more subjective.

While the line between social and normative motives is not always clear, it is interesting to think that social compliance motivations could sometimes even overrule normative motivations: For example, if a person believes that a law is just and fair, but if obeying the law is not accepted within the person´s social group, social motivation can overrule normative motivation. Such situations can typically be observed among young people who join youth gangs, which approve the use of drugs.

This leads me to think that the best approach to distinguish between normative and other social factors might be to focus on voluntary and involuntary behaviour (e.g. group pressure would suggest involuntary behaviour).

## Normative Compliance Theory

Scholars of this school emphasise the voluntary aspects of compliance, which are not necessarily rational and hence easily overlooked by mere economic models.
In particular, the procedural justice compliance model, will be discussed in this section roots in the idea that people do "internalise" normative values like legitimacy and personals. Scholars argue that these then guide the cognitive decision making towards compliance behaviours. Consequently, a normative compliance model can be viewed as another school of thought in the field of compliance research, which co-exists with the above-mentioned utilitarian compliance model and the social compliance theory.
Normative and social models of compliance are similar, as both focuses on compliance behaviour, which is not necessarily related to economic benefit. They are, however, distinct, as normative motivations derive purely from internalised (cognitive) factors, while social motivations also relate to external factors such as earning the respect of other group members (Tyler (2006), 42 – 45). In other words, if a person complies with a law because he or she believes that the law as such or the authority enforcing the law is just and in alignment with the person´s inner moral values, this can be considered an example of internally motivated normative compliance. If on the other hand a person obeys a law not because he or she believes that the law is just, but because he or she does not want to lose the respect of his or her group members (e.g. family and friends), this would be an example of socially motivated compliance.
As Tyler (2006) explains, the underlying idea behind a normative compliance model is the concept of "legitimacy" and "procedural justice". Broadly speaking procedural justice refers to the idea that the "just" treatment of a person during a "procedure" (e.g. court procedure or inspection by a police officer) by representatives of an authority can enhance the support of values that a person has towards the authority that is imposing the procedure against him. In other words, the normative compliance model assumes that an individual that experienced procedural justice would "internalise" their belief in the legitimacy of this authority and that this belief would then facilitate voluntary compliance behaviour in the future. Similarly, a negative experience would lead to the opposite effect. W. Braithwaite (2017) takes this even one step further and suggests that normative compliance should be understood as a

process, which is in continuous movement between the different social groups, which represent the authority and those who have to comply.
According to this idea regulators should aim at the "social reality" of those that are regulated to ensure that the authority´s regulatory actions are viewed as fair, just and beneficial in order to foster voluntary compliance behaviour. In some sense this theory resembles the thoughts of Beccaria (1764), who previously argued that compliance behaviour is based on an underlying deeper moral and the idea that rules are meant to benefit everyone in a society.
That leads to the question, what exactly is "procedural justice"? Murphy (2017) noted that it involves more than the regulator simply being nice to people. The criteria used to define the concept of procedural justice usually involve procedurally just treatment including respect, neutrality, trustworthiness and voice.
According to Leventhal (1980), who was one of the early scholars writing on this concept, the following general rules determine the existence of procedural justice: Suppression of bias, accuracy, correctness and consistency in the procedure, as well as representativeness and ethical standards.
In reality, these rules are probably not much more than indications for the existence of procedural justice. They fail however to explain what procedural justice actually is. The problem in determining a concept of procedural justice is that it involves the concept of "justice" or "just treatment". The concept of justice is by itself not easy to grasp. Different interpretations of the concept of justice do necessarily also lead to different interpretations of the concept of procedural justice.
Early research in the field of procedural justice often defined justice based on an outcome-oriented interpretation. For example Thibaut and Walker (1975) developed a procedural justice model, which explains "mechanisms" for decision making in a legal procedure. Even though they acknowledged that it is important that legal procedures have to be fair and that it is significantly important to hear "the voice" of the individual who is subject to a legal procedure, their model was very much focussed on the outcome of a procedure. Accordingly, a fair procedure must result in a fair outcome.
An outcome-oriented definition of justice appears reasonable for an objective third party who is not involved in a procedure. The difficulty with this definition, however, is that people would often see themselves as deserving a more favourable outcome than others might grant them. As a result, people who experience legal

procedures with unfavourable outcomes would be unlikely to support the authority in the future.

For this reason, later scholars in this field, such as W. Braithwaite (2017), disagree with an outcome oriented definition and argue for a process oriented definition of just treatment.

Also T. Tyler and Blader (2003) have rejected such an outcome-oriented definition and argue that justice should instead be understood as something that is directly linked to quality of treatment, such as being respectful, polite and "hearing the voice" of the individual under procedures. High quality treatment of the individual involved in legal procedures promotes cooperation and commitment, opposed to anger – regardless of the outcome. Building on this idea and with the aim of understanding how quality treatment influences compliance behaviour more clearly, advocates of this school of thought seek to explain the psychological mechanisms, which underlie procedural justice. Researchers in this field have abstracted the relationship between the authority and the individual experiencing legal proceedings to a more general level. For these researchers procedural justice is seen as interaction between individuals within a group (the authority representing the group leader). Ultimately, understanding the factors that shape the relationship that people form within their respective group became a key concern for researchers in the area of procedural justice. Later theories in the field of procedural justice focus on these social relationships and aim to explain the symbolism related to a person's value beliefs, attitudes and status in society (Murphy, 2017).

Three new models emerged from this new socio-psychological perspective (see table below).

| Model | Focus |
| --- | --- |
| Group-value Model | • Focus on procedural justice judgments within a group (shared values within a group). |
| Relationship Model | • Focus on procedural justice judgments in relation to authorities and leaders.<br>• Relationship concerns (e.g. standing) are important factors. |
| Group Engagement Model | • Focus on attitudes and values within a group.<br>• Assumes that identity judgments directly shape attitudes, values and cooperative behaviour. |

**Table 1***: Comparison of Models of Procedural Justice According to T. Tyler and Blader (2003).*

The group-value model puts the value of the group at its centre. According to this model people would develop such strong identification with a group, that they would finally put aside their self-interest and act in the interest of the group (T. Tyler & Blader, 2003). The group in this context of course is the society in which individuals are the individual citizens and the group leaders are the representatives of the authorities (e.g. police officers or judges at a court of law).

The relationship model is distinct, as it determines compliance behaviour by exploring the factors that shape reactions to the authorities (T. Tyler & Blader, 2003).

Lastly, the group engagement model is distinct, as it provides certain determinants for cooperation of an individual with a group. These determinants are 1. identity implications (does the individual identify himself with the group?) and 2. resource implications (does the group provide any surplus or loss of resources?).

### The Group Engagement Model of Procedural Justice

The group engagement model is probably the most advanced one of these three models and will therefore be discussed in more detail:

Within the group engagement model identity implications are considered more important than resource implications. There are three aspects of identity implications: Identification, pride and respect. The more an individual is able to identify himself with a group, the more likely he is to cooperate with this group. The model assumes that fairness of group´s procedures is the most significant factor for an individual to identify himself with a group (T. Tyler & Blader, 2003).
In other words, the group engagement model explains procedural justice as a concept of group identity and group commitment. The more one identifies himself with a group the more he would engage and cooperate with this group voluntarily. The way that procedures are executed within a group influences how strongly one identifies oneself with this group. In this model the government authority represents one group. Policemen, prosecutors and judges at legal courts represent this group. If this group applies fair and respectful procedures, individuals would identify themselves as part of this group and would engage themselves and cooperate voluntarily. Vice versa, unfair procedures would have the opposite effect. The figure below illustrates the functionality of the group engagement model of procedural justice.

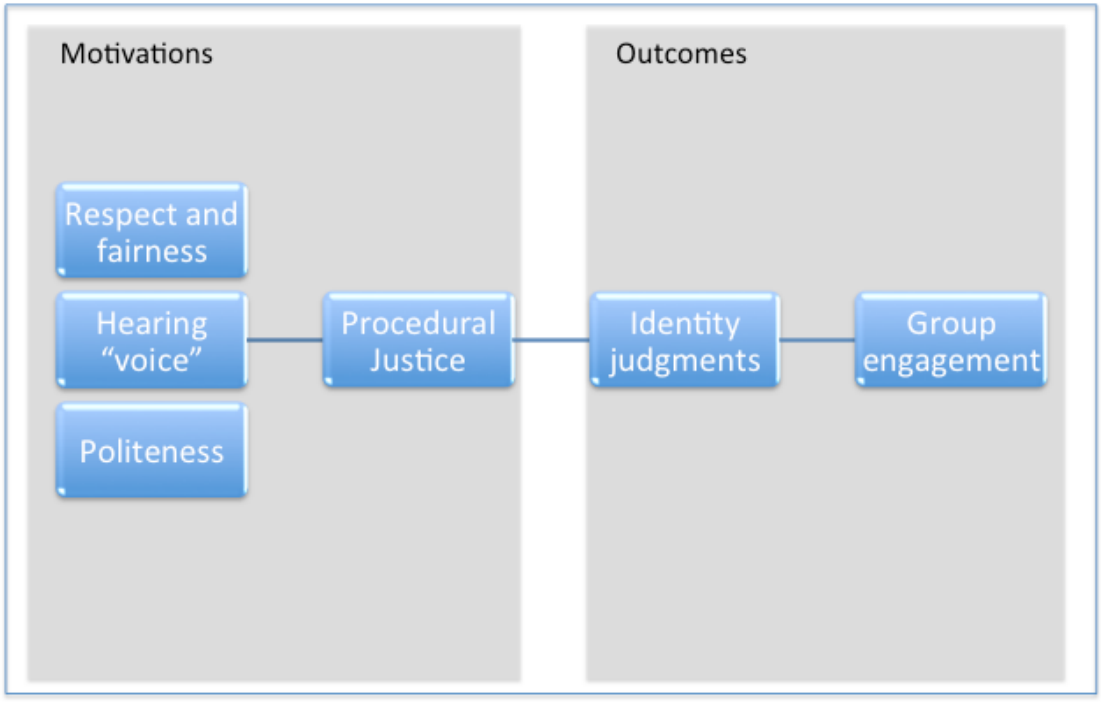


**Fig. 1***: Group Engagement Model (Based on T. Tyler and Blader (2003).*

All three models of procedural justice focus on the relationship between an individual and his identification with a group. The latest thoughts on how procedural justice influences compliance behaviour aim to integrate this aspect with the role of emotions (Barckworth & Murphy, 2015; Murphy, 2008). Such an advanced model

of procedural justice suggests that when unfair treatment threatens one's identity, negative emotion may be the result. These negative emotions will then have the potential to make an individual person question the legitimacy of the authority and may thus lead to non-compliance. Research in this field will moves very fluently into the field of psychology and behaviour science.

## Further Schools of Thought

While all three models together form a larger "compliance theory", each of the three forms its own smaller compliance theory within this framework.

The figure below summarises these major compliance models.

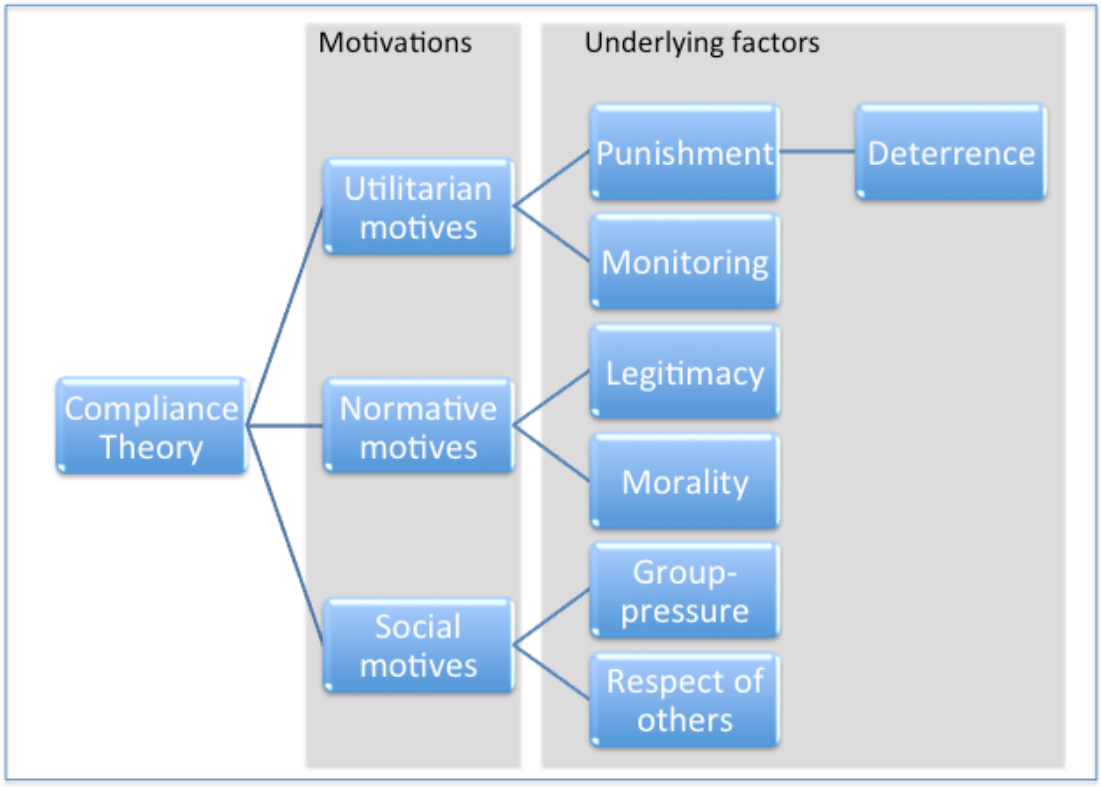


**Fig. 2***: Overview of Major Compliance Models.*

To make the picture complete, two other alternative schools of thoughts should be mentioned:

Firstly, some scholars have argued that compliance behaviour can simply be explained as a habit (e.g. mentioned in Bottoms (2002)). According to this theory compliance behaviour depends on the personal habits that people have developed. This school of thought seems, however, not to be widely followed in the literature. The reason for the little significance of this theory may be the fact that it is of little practical use in policymaking.

Secondly, one could think of a school of thought arguing for an obstructive compliance model, meaning that breaching a rule would be made factually impossible (e.g. mentioned in Bottoms (2002)). Much like the habit model, an obstructive model is merely of theoretical importance, as it would be impossible to

apply in most real-life situations (i.e. it seems impossible to lock up all potential offenders in prison in order to obstruct them from breaking the law).

## Corporate Compliance Theory

The above sections have outlined the emergence and status quo of compliance theories in the literature.

As this literature review aims to provide an overview of compliance theory in the context of our modern business life, the next logical question must be, if (and to what extent) these theories can also explain the compliance behaviour of organisations such as companies. The following sections therefore seek to explore the part of the literature that illustrates how these theories have been applied and which specific models have been developed in a business or organisational context ("corporate compliance" or sometimes called "business compliance").

### Different Approaches for Corporate Compliance Research

Companies are not people and yet they enjoy much of the same moral and legal status claims Garthoff (2019) when observing US legal practices. Garthoff argues for a revision of this status to instead treat companies as organisations of multiple individuals, which are represented by an agent. Consequently, research into the compliance behaviours of companies must be done from a different epistemological standpoint.

For example, economic motivations such as financial penalties for non-compliance are obviously an important factor that influences the compliance behaviour of companies, as well as individual people. What is less clear is, if and to what extent normative and social motivations may also be relevant in the context of corporate compliance.

Measuring what motivates compliance in a company is different to measuring what motivates compliance for an individual person. A different approach is therefore used in corporate compliance research. For example, how can we measure the compliance failure at the German company, Siemens, that caused it to fail compliance with relevant anticorruption laws and led to the gigantic $ 1.6 billion fine imposed on Siemens by the US Securities and Exchange Commission in 2008 (Schubert & Miller, 2008)? Only recently Blanc, Cho, Sopt, and Castelo Branco (2019) described how Siemens has dealt with this corruption issue in terms of disclosures made in the company´s annual report and sustainability reports in order to analyse how Siemens tried to regain legitimacy from stakeholders within and outside of the organisation. This study did, however, not venture into the discussion,

of whether or not Siemens as an organization failed to comply with anticorruption law. The following thoughts will illustrate why this is a difficult question:
Let´s assume Siemens has 5,000 employees. If one of these employees breaks a law that is relevant to the company's business activity (e.g. if a company like Siemens is exporting machineries and the employee is a sales manager who used bribery to increase his personal business success) would this mean that this company failed to comply as a whole or is the company only a "victim" of a criminal employee?
How would we judge, if in the same situation 60 employees failed to comply with a relevant law? Would it make a difference, if the misconduct were performed by a lower ranking employee or by a senior manager? How would the economic impact of the misconduct change our judgment of the company´s compliance behaviour?
These questions illustrate an important difficulty for the application of classical compliance theories in the field of corporate compliance: The problem is that due to the fact that a company is not an individual person, but an organisation constructed by many individual people, the dichotomy of outcome-oriented theories ("compliance" and "non-compliance") is insufficiently defined to develop a theoretical model that explains compliance behaviour at a company level appropriately. Ten years ago, C. Parker and Nielsen (2009) have reviewed a variety of empirical research studies conducted in the field of corporate compliance. They concluded that because of these difficulties most researchers follow either an approach that regards compliance as exogenous to their research and seek to understand causalities of compliance behaviour or they seek to better understand what "compliance" actually means in a specific business context and treat it therefore as endogenous to their research work.
If researchers aim to establish a link between cause and action, they face the challenge that they must consider compliance behaviour as exogenous to the research and any possible outcome of an action must therefore be clearly defined.
As a consequence, research into corporate compliance requires a much more detailed and individualised definition of the terms "compliance" and "non-compliance". This definition must serve as a fixed variable to measure what causes both behaviours. This becomes more vivid in certain studies than in others. One good example is a study on regulation and compliance within fisheries presented by Grezelius (2003). Grezelius analysed normative motivations for compliance behaviour among Norwegian and Newfoundlandian fishermen. These fishermen also form small

organisations (often even registered as companies), consisting of a commander and one or several workers on board a vessel. In order to establish any causality, Grezelius had to predetermine what non-compliance would look like in this business. In the case of fishery businesses this was relatively easy, as he could objectively use measurable criteria such as the size of the boat, the size of the net or the amount of fish caught per year. There are multiple examples of compliance-related research that defines objectively, what "compliance" and "non-compliance" mean in a specific context in order to have a fixed reference to measure what motivates compliance behaviour (e.g.Charlesworth (2017), Taplin, Y., and A. (2014), Lee (2013), Workman (2009)).

However, as C. Parker and Nielsen (2009) had rightfully predicted, a core problem with this approach is that the definition of what "non-compliance" means cannot be made without setting a standard for what "compliance" should mean in a specific regulatory context. While positive compliance behaviour may be relatively easy to determine in cases like fishery regulation, where, for example, the size of the net is objectively measurable, it becomes very complex and requires special expert knowledge in other contexts such as regulation for financial services providers.

Another problem with studies in a business context relates to the fact that these studies deal with organisations rather than individuals. Different motivations may exist at the same time in an organisation.

For example, failure to treat customers fairly could result in a regulatory fine for a bank, causing economic damage to the company. As Kagan, Gunningham, and Thornton (2011) noted, companies are licensed to produce profit for their investors and therefore the fear of realising losses or even the fear of reputational damages could be internalised by the managers of a company and thus normative motivations could also become relevant.

Simultaneously, social factors like peer-behaviour and corporate culture influence how many resources and efforts a company invests to ensure compliance. As explored by Ellinas , Allan, and Johansson (2017) peer-pressure and influence on the social rank are a particularly problematic factor within the financial services industries.

All of these factors make it more difficult for researchers to establish a clear causal relationship for compliance behaviour in a business context. Additionally, these issues increase with the size of the company under investigation. Hence, while the

number of individuals on board a small fishing vessel is still relatively manageable for a researcher, this becomes very problematic in field studies in relation to large multinational companies.

Consequently, research in corporate compliance up until today remains a challenging field. A systematic literature review of studies relating to monitoring of regulatory compliance performed by Akhigbe, Amyot, and Richards (2016) looked into 1,207 candidates and selected only 9 as fully relevant. These 9 articles showed that works relating to research in the environmental, health and agricultural domain dominates research in this area. Generally, the authors note a lack of empirical work and proclaim their surprise that no relevant works related to compliance in relation to crisis in the banking sector and privacy concerns are not reflected in the literature they have identified.

### Process-oriented Compliance Theory

The outlined challenges for outcome-oriented compliance research are all related to a lacking definition of the terms “compliance” and “non-compliance” that could easily be applied to any business-related compliance research. This problem has led to the formation of another area of corporate compliance research. Researchers in this area are not primarily concerned with the causality of compliance behaviour but seek to understand and conceptualise compliance behaviour as such. According to C. Parker and Nielsen (2009), these researchers use an approach that views compliance behaviour as endogenous to the research. Researchers using this approach will typically use research methods that work well with their epistemological stance. They will, for example, use qualitative research methods and focus on the social construction process within an organisation and seek to understand how a meaning for compliance or non-compliance is constructed and what it looks like in the end. One notable example for this approach is the research of Edelman and Talesh (2011). They argued that corporate compliance should be understood as a process by which companies construct the meaning of laws and regulations and transform them into behaviour. According to such a process-oriented model, compliance behaviour is no longer just outcome-oriented. Instead, compliance behaviour relates to the process by which a company constructs meaning out of law and derives actions based on its own interpretation.

Elaborating on this concept, Edelman and Talesh suggested the idea that law and compliance evolve through the flow of ideas across social fields (“processual model of corporate compliance”).

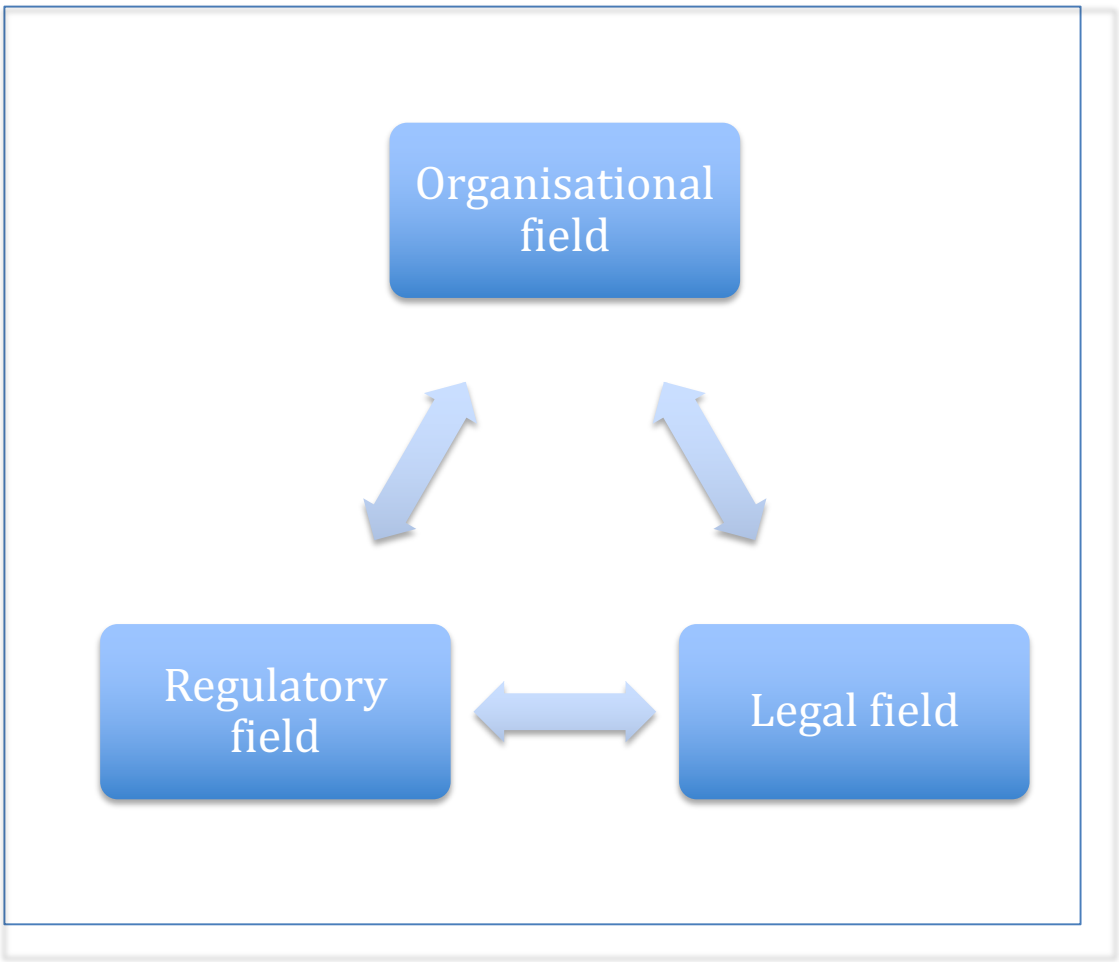


**Fig. 3***: Theoretical Framework for a Processual Model of Corporate Compliance (based on Edelman and Talesh (2011)).*

Legal rules are not always easy to understand and legal ambiguity opens space for social construction of new meaning. Accordingly, the legal field (i.e. lawyers, courts, regulators, etc.) and the organisational field (i.e. companies with all related stakeholders) are continually influencing each other in a constant debate about the question of what compliance behaviour should actually look like.

Drahos (2017) takes this idea one step further by arguing that there may even be an interaction within the "legal field" itself that leads to a globalisation of regulation by exchange between different regulators.

More recently Root (2018) presented a new process-oriented compliance theory called "The Compliance Process". According to this theory organisations achieve compliance in a continuous process of prevention, detection, investigation and remediation (see figure below).

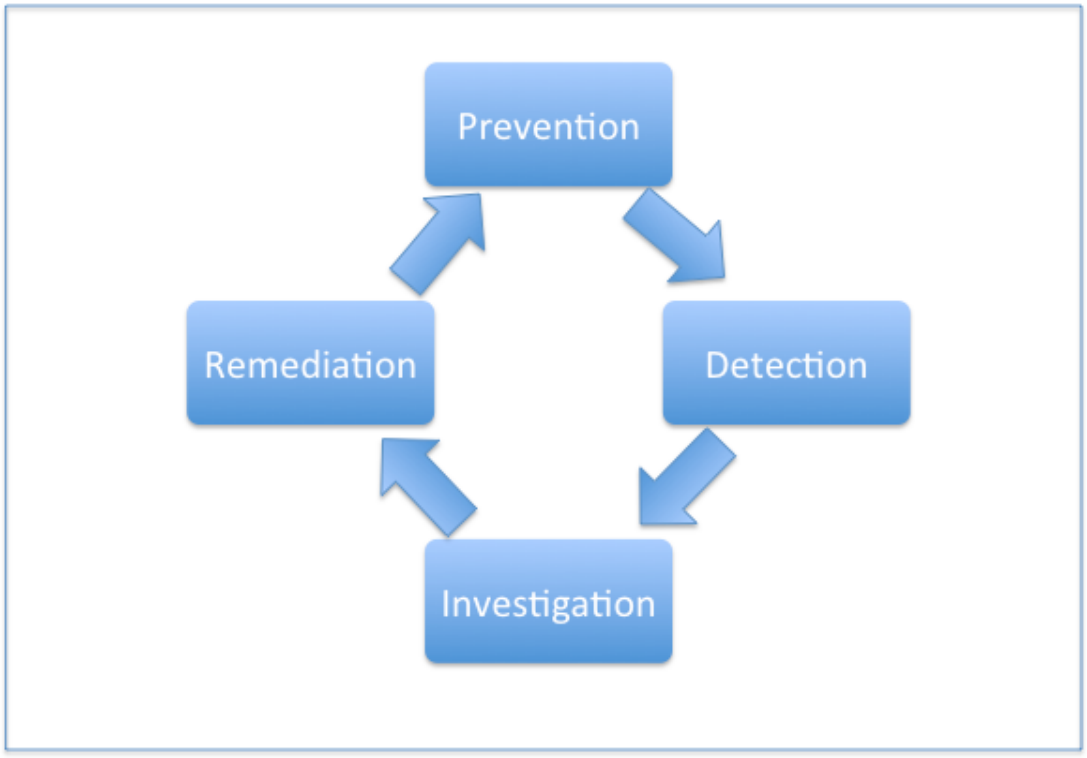


**Fig. 4***: Theoretical Framework for a Processual Model of Corporate Compliance (based on Root (2018)).*

While also focussed on a "compliance process", Root´s theoretical framework differs from the work of Edelman and Talesh, as it aims to provide a model that is limited to actions within a specific organisation, rather than interaction between the organisational, legal and regulatory fields. This model has the advantage that it can help companies develop concrete actions in order to improve their own compliance behaviour. On the other hand, such a model ignores the multiple interactions that exist between a company, external lawyers and regulators.

### The Role of Corporate Culture

All processual models of corporate compliance acknowledge the importance of corporate culture in order to make the process work.

Corporate culture can be seen as "the oil" in the gear of the various processes. There are multiple concepts of corporate culture: Organisational culture manifests in rituals, stories, humours, jargon, physical arrangements and formal structures and policies (Martin (2002), 55). Or, as Blomfield, Campbell, and Ashbidge (2018) have phrased it, culture is "*the way things are done around here*".

In a corporate compliance context this means that, if legal rules dictate certain behaviours within a company, the individual actors within the company will interpret their own meaning out of such rules, based on their individual knowledge, habits and assumptions. Laws and regulations have thus the potential to change habits, assumptions and routines within a company and are thereby indirectly influencing the corporate culture of the respective regulated companies.

Furthermore, Haugh (2017) noted the problem that people in professional business life have a tendency to "rationalise" unethical behaviour. The idea that offenders rationalise unethical behaviour was originally proposed by Cressy (1953) and relates to the theory that people develop rational explanations in order to convince themselves that their wrongdoing is justified. According to Haugh (2017) this theory is especially relevant in the context of corporate compliance, as professionals working for regulated companies can often be seen to rationalise their unethical behaviour.

In a process-oriented model of corporate compliance such actions could in turn even influence the regulatory and legal fields and could ultimately cause bad conduct to become acceptable compliance behaviour.

While a process-oriented model of corporate compliance certainly adds to the theoretical understanding of corporate compliance, from a practical perspective it imposes various new challenges for regulators attempting to ensure that companies follow the relevant laws appropriately. This is because such a model implies that we have to accept that companies are developing their own ideas about what compliance behaviour means. These ideas are then embedded in the thinking and acting of professionals working within a business organisation. The crux with this is that such professionals may interpret laws very differently from actors in the legal field or from what the lawmaker had originally intended.

### Alternative Regulatory Measures

Additionally, as certain compliance behaviour will likely become "best practice" in an industry, the organisational field equally influences the understanding and interpretation of actors within the legal field. This is specifically important, if we consider that many actors in the legal field such as law firms or public accountants actually work for these companies and depend on the earnings that they gain from offering their services to the regulated companies.

The idea that companies construct their own meaning of compliance has led to the development of some "alternative regulatory measures". One important alternative regulatory measure is the concept of "self-regulation". This concept is indivisibly connected to the underlying idea of "regulatory capitalism". The term "regulatory capitalism" describes a change in regulatory approach that began to emerge in the late 20th century and still exists today in the USA and many other western countries (Lobel, 2004). Regulatory capitalism has two main features: Regulators tend to "responsibilise" companies to self-regulate in order to ensure policy goals (Shamir, 2008) and regulation becomes more decentralised driven by international networks and not by single states (Solomon, 2008). According to Levi-Faur (2017) regulatory capitalism thus changes the way politics is carried out.

The idea of responsibilising companies means allowing them to determine what appropriate compliance behaviour means. As noted by C. Parker and Nielsen (2009) corporate compliance becomes increasingly the result of a negotiation between regulated companies and a range of civil society, professionals and industry. However, while this sounds a bit like regulators have given up on doing their job, this idea is actually an application of the concept of normative compliance: If companies are treated fairly and if their "voice" is heard and respected by the regulator, this may very well improve engagement and voluntary compliance behaviour (T. Tyler, 2011).

Furthermore, as outlined above, the process-oriented compliance model suggests that an organisation's compliance behaviour is determined by a company´s intrinsic capacities and characteristics. As it would be impossible for a regulator to govern and control the internal resource allocation and corporate culture on a day-to-day basis it seems to be a smart idea to shift this responsibility back to the companies themselves.

### Compliance Management Systems

According to Grabovsky (2017) the concept of self-regulation also entails the idea of "regulatory pluralism" and means acknowledging that regulatory forces within the private and the public sector exist. Regulatory forces can exist, for example within the Legal field (e.g. in the form of private law firms that determine how certain regulation should be understood), in the form of Industry Associations (determining best practice standards) or in many other forms.

Furthermore, one important regulatory force exists within the regulated companies. Regulated companies have developed certain internal management structures that aim to prevent the company from breaking the law. C. Parker (2011) has called such a structure a "compliance management system". A compliance management system (or CMS) consists of management structures within a company that enable the managers of the company to control compliance behaviour throughout the organisation. Typical elements of a CMS are a dedicated Compliance Officer, a Compliance Program consisting of training and monitoring activities and a Compliance Report to the management.

The concept of responsibilisation and the existence of regulatory pluralism (particularly the emergence of CMS) have finally inspired regulators, especially in the financial services industry, to ensure compliance not just through external "policing", but rather by requiring companies to install proper compliance management systems to "self-enforce" proper compliance behaviour. Such regulation is known as "meta-regulation" (C. Parker, 2007). According to J. Braithwaite (2017) such enforced self-regulation was a founding idea of the concept of "responsive regulation" in the late 1980s.

One prominent example of such meta-regulation is the UK Financial Conduct Authority´s rules regarding fair treatment of customers. According to the so called "Treat your Customers Fairly rules" (TCF), financial services providers, such as banks and investment companies in the UK are required to review their own business conduct and implement organisational measures to treat all customers fairly. [1]

Instead of providing detailed rules about what it means to treat customers fairly, TCF regulation predominantly consists of guiding principles. Hence, instead of telling the companies what needs to be done to treat customers fairly, companies are required to make their own considerations on what that actually means. This type of regulation is mainly outcome oriented. Thus, a company can only be sure to comply with TCF requirements, by developing their own unique organisational measures to ensure fair treatment of customers in all situations. Such measures will have to include internal compliance training, monitoring and other organisational measures and are unique to every organisation. In other words, in order to comply with TCF companies are required to build their own effective CMS and thus to "regulate themselves".

[1] See FCA Handbook COBS 2.1

The idea of requiring companies to build their individual CMS is appealing to regulators, as each individual company knows best how to ensure that all members of the organisation comply with the rules. Additional advantages are psychological factors i.e. it is probably easier for employees to accept their company´s own compliance guidelines, than to accept the law itself. T. Tyler (2011) argued that the authorities do not actually need to provide incentives or sanctions to everyone to ensure compliance with the laws, if (and to the extent that) voluntary cooperation can be achieved.

Another advantage of such meta-regulation is more effective monitoring of compliance breaches amongst a company´s own staff. No regulator can monitor the misconduct of employees as effectively as the company´s own internal compliance department. To some extent meta-regulation therefore enables regulators to outsource monitoring back into the company itself.

While this sounds like a promising path for future regulators, some researchers have also critiqued the idea of self-regulation: Gilad (2011) analysed how financial service companies in the UK reacted towards the TCF regulation and concluded that many companies refused to operate adequate compliance management systems on a voluntary basis. Only when the regulator began to enforce the new regulation by asking for evidence of their compliance management systems and by punishing companies that failed to take the new approach seriously, did the new regulation become effective. More recently, Gunningham and Sinclair (2017b) presented new empirical results and even claimed that the concept of meta-regulation may not work at all, as it would simply shift existing problems with compliance behaviour from the outside of the firms to the inside. This led to the latest development in the area of responsive regulation, which was labelled “smart regulation” by Gunningham and Sinclair (2017a). Smart regulation aims to combine the concept of self-enforced meta-regulation with a closer collaboration between the regulator and other “regulatory forces” such as non-governmental organisations.

Given the justified critique of the concept of self-regulation and the on-going debate on the effectiveness of meta-regulation, further research is needed in the area of corporate compliance.

Particularly, the existing knowledge of compliance management systems seems to lack empirical insight. It is not clear, how companies develop such systems in practice. Therefore, we have only limited knowledge of the real problems that

companies have to overcome, when they build and operate a CMS (e.g. Which principal-agent issues may arise? Which stakeholders assume which role in a CMS? Are there any conflicts of interest?).

### Limitations of Process-oriented Compliance Theory

More generally, it seems that for a process-oriented model of corporate compliance in order to be really useful, it would be required to "go one step further" and to illustrate the precise process by which specific companies are shaping the meaning of compliance, rather than understanding the universal process as illustrated in the two models shown above (figure 3 and figure 4).

Edelman and Talesh (2011) acknowledge that more research is needed to investigate the various ways in which diverse mechanisms are at play in shaping meaning of compliance within an organisation. While their theoretical framework describes a process that is driven by stakeholders from the organisational, legal and regulatory field, in fact little is known about the true identity of, and complex interplay between, the stakeholders representing these fields.

A more nuanced process-oriented compliance theory should therefore address in detail which stakeholders exist and are influencing the compliance behaviour of a company. These stakeholders include individuals within a company (e.g. the board of directors, the Compliance Officer, the Legal Counsel, the Risk Manager, etc.) and stakeholders external to the company (e.g. external consultants, auditors, regulators, industry associations, etc.). Because these stakeholders are different in diverse industries (and sometimes also different in companies within the same industry), empirical research that explores the role of these stakeholders seems to be a promising route to follow.

Furthermore, the theoretical framework developed by Root (2018) seems also limited: This framework focusses on the process of prevention, detection, investigation and remediation (see figure 4) as the root-course of compliance behaviour of companies. As Root (2018) acknowledge, the purpose of such a compliance process is for a company to ensure that it´s employees (i.e. the agents) are not violating any laws, when acting on behalf of the company (i.e. the principal). However, Root (2018) does not venture into exploring any of the conflicts of interests that can arise in a principal/agent relationship, nor does she make a

distinction between the company as an organisation acting on a “macro-level” and the employees of the company acting on a “micro-level”.
Additionally, it seems too simple to assume that “one compliance process” can summarise all processes companies facilitate to achieve compliance behaviour. In fact, there may be different types of processes in place that determine the actual compliance behaviour of a company. For example, there may be processes that are used by these companies to adjust themselves and re-organise in order to ensure compliant behaviour towards new regulatory requirements (“change” of a compliance management system). And, there may be processes to ensure that the company and all its employees are continuously complying with all relevant regulation (“run” of a compliance management system). Both types of processes will be prone to different issues which can impair their effectiveness and can, thus, lead to a situation, where the company is not in compliance with a certain regulatory requirement. Various stakeholders will play different roles in such diverse processes. Therefore, only a detailed and nuanced understanding of these various processes and related issues can help to develop better regulatory responses to companies with poor compliance behaviour.

## A Holistic Compliance Theory

The process-oriented models outlined above give us an idea of how compliance behaviour can look, but they do not help to understand what actually motivates compliance behaviour within a corporate compliance context.

Therefore, another group of researchers have aimed to understand the causalities of compliance behaviour in a company. These researchers follow a different approach, as they are not aiming to understand what compliance behaviour looks like, but rather what motivates compliance behaviour. This approach also influences their research methodology. Researchers of this school of thought often use quantitative methods, such as surveys effectively.

One important example of such research is a study that used a large scale survey in order to uncover the relevance of different motivations for corporate compliance, presented by C. Parker and Nielsen (2012) under the title "Mixed Motives: Economic, Social and Normative Motivations in Corporate Compliance" ("Mixed Motive Survey").

### The Mixed Motive Survey

Given the relevance of this study for the development of a holistic compliance model, the content of this study should be discussed in more detail in the following section. Three hypotheses were made at the beginning of their study:

1. It was expected that compliance within a company is determined by economic, social and normative motivations;
2. It was expected that no company would be motivated exclusively by a single one of this three, but rather a mix of all of them and;
3. It was expected that certain clusters of relevant motivations could be found according to the size, organisational resources and market position of a company.

To test these hypotheses, a large-scale survey among large Australian companies was performed and quantitatively analysed. The empirical results of this study confirmed all three hypotheses and revealed some additional interesting results:

It was concluded that the participating companies could be clearly divided into three different categories, depending on the role of economic, social and normative motivations. C. Parker and Nielsen (2012) labelled these categories as follows:

- "optimizers" (companies that strongly correspond to all three motivators),
- "non-engagers" (companies that aspire to fundamental economic and normative values, but less than "optimizers" and that downplay the role of social motivations) and
- "dissenters" (companies that mainly respond to economic motivations, but much less to normative or social motivations).

The empirical results of this study suggested further that the majority of the responding companies belonged either to the category "optimizers" or "non-engagers". Only the minority fell in the category of "dissenters". This is interesting to note, as it clearly shows that most companies are in fact not simply motivated by mere economic motivations such as legal penalties. The table below illustrates the findings for the three clusters in detail.

| | **Cluster 1: Optimizers** | **Cluster 2: Non-engagers** | **Cluster 3: Dissenters** |
|---|---|---|---|
| **Cluster information** | | | |
| Number of businesses | 447 | 413 | 81 |
| Per cent of Total | 48 % | 43 % | 9 % |

**Table 2:** ***Three Clusters of Corporate Compliance, based on C. Parker and Nielsen (2012), 14.***

Besides these results another interesting outcome of this study was the unexpected emergence of a new category of normative compliance: Traditionally normative compliance relates to either the general acceptance of law and/or authority or to the acceptance of a certain goal behind a law or a certain authority. C. Parker and Nielsen (2012) observed that some senior managers were willing to ask themselves the question: "Is there an overriding substantive goal that might justify (or rationalise) my non-compliance in this situation?" They labelled this normative motivation as "non-contingent compliance". Although non-contingent compliance does not motivate compliance, it is certainly a strong motivation for non-compliance.

## Emergence of a Holistic Compliance Theory

Based on the results of the "Mixed Motive Survey" Nielsen and Parker created a new theoretical framework for a holistic compliance model. The holistic compliance model assumes that every company will make internal decisions in accordance with its specific organisational capacities and characteristics in order to comply with a specific law. How the actual compliance behaviour will look depends on the one hand on how strongly a particular company reacts to economic, social and normative motivations related to the law; and on the other hand to the specific company´s internal decision making, implementation and on the available resources. Furthermore, and in alliance with the concept of regulatory pluralism, the model also assumes that informal institutions will have an indirect and formal institutions will have a direct effect on the actual compliance behaviour.

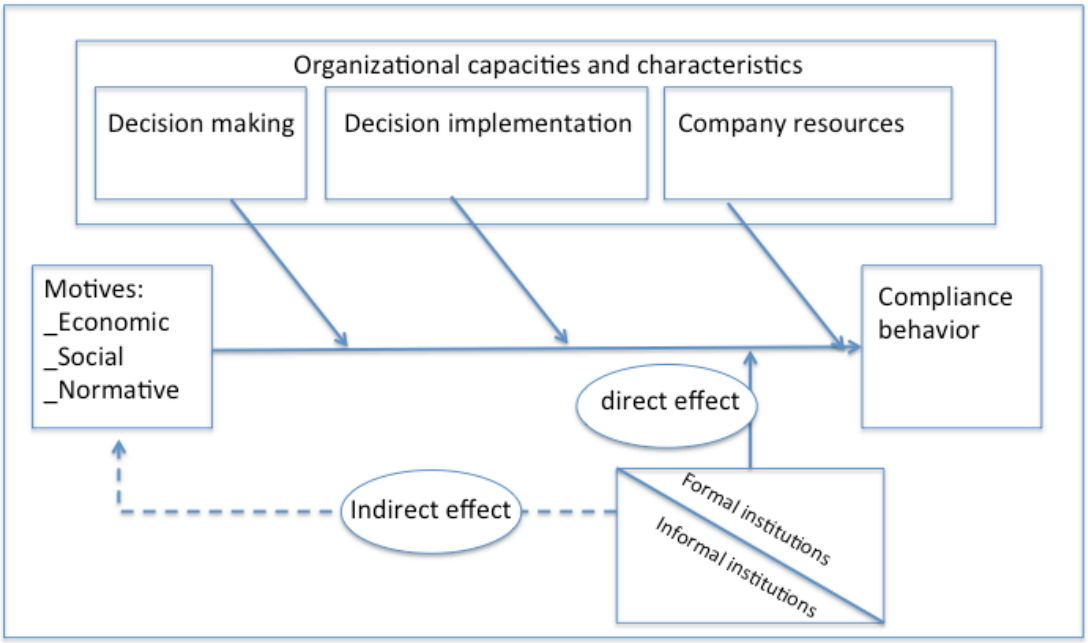


**Fig. 5***: The Nielsen-Parker Holistic Compliance Model.*

More recently C. Parker and Nielsen (2017) have combined their holistic compliance model with a set of questions called the "Table of 11" (T11) that was developed by Ruimschotel (2004) in order to develop a tool for forecasting compliance behaviour for new regulations. This tool can now be used to forecast the compliance behaviour of a target group of companies for a new regulation.
Ultimately, the holistic compliance model is important in the area of corporate compliance research, as it is the only model based on empirical research, that is able to integrate multiple motives (economic, social and normative) into one single model. The model is, therefore, useful to map and forecast how good (or bad) certain organisations will likely comply with a specific new law.

### Limitations of a Holistic Compliance Theory

C. Parker and Nielsen (2012) acknowledge that further research is needed to better measure and specify the ways in which the motives of individual executives and workers in a large firm relate to the overall motives and actions of the company. Such further research should aim to identify the various individuals within and outside the company that are driving or are driven by economic, social or normative motivations. Likely, a company´s top executive is driven by other motivations than a company's salesclerk. At the same time, a salesclerk has a very different (i.e. limited) influence on the company's actual compliance behaviour than a top executive.
This leads to another problem with the model developed by Nielsen and Parker: It seems that the model treats a company as a "closed entity", which reacts "through the company´s senior management" to different motivations. But, in reality, a company is more complex and consists of many more relevant stakeholders, than only the senior management. These stakeholders assume very different roles within and outside the company. A more nuanced model with a specific view on the role of internal and external stakeholders would help to gain a better understanding of how their interaction, which is influenced by various motives, ultimately leads to the company´s compliance behaviour.
Lastly, their model tells us that the compliance behaviour of a company is not exclusively driven by motivation. Every company will make internal decisions in accordance with its specific organisational capacities and characteristics in order to comply with a specific law. Moreover, formal and informal institutions will

influence the actual compliance behaviour of a company. Or, as Nielsen and Parker phrase it, wanting to comply is not the same as actually complying. Thus, further research that examines “how” compliance behaviour actually looks within regulated companies would help to better understand, what these specific organisational capacities and characteristics are and how they influence the actual compliance behaviour.

## Chapter Summary

As explained in the beginning of this chapter, the purpose of this literature review is not to deduct a research objective or to develop detailed research questions. Instead and guided by the abstract research question of what compliance behaviour actually looks like within a regulated firm, this literature review has outlined the development of three main theories in the field of compliance research:

- The rational choice compliance theory
- The social compliance theory
- The normative compliance theory

Furthermore, the chapter discusses how researchers have applied and tested the validity of these general theories in the context of modern business life. While it was concluded that all three theories are relevant in the context of corporate compliance (this was one result of the "Mixed Motive Survey"), it was also shown that each of these theories must be applied differently on an organisational and individual level. These differences are caused, by the fact that an organisation consists of multiple individuals and that therefore various motivations for (and against) compliance can exist at the same time within different individuals in one single organisation. Furthermore, organisational behaviour is not limited to a simple binary outcome, such as "compliance" or "non-compliance", but can be much more diverse.
The literature review showed that researchers in corporate compliance seem to fall into two different schools of thought: One group regards compliance as exogenous and the other as endogenous to their theories. Researcher within the former group seek to understand causalities of compliance behaviour (e.g. C. Parker and Nielsen (2017)). Researcher within the second group seek to understand what compliance behaviour looks like and how it is constructed in a company, regardless of causality (e.g. Root (2018)). Based on these two standpoints, two models for corporate compliance were presented:

- The holistic compliance model (compliance behaviour is seen as "exogenous")
- The process-oriented compliance model (compliance behaviour is seen as "endogenous")

Both models leave us with the problem that how the output (the actual compliance behaviour) looks in reality in a concrete industry or organisation, such as a German asset management firm, cannot be explained. We do know from these theories that certain motivations lead to compliance or non-compliance behaviour, but what compliance and non-compliance means is limited to a pre-determined definition. Particularly, the existing models are not sufficiently nuanced in order to help us understand the actual role of the various stakeholders of a company. As a result, the "black-box" of what compliance behaviour really looks in a specific company, such as an asset management firm remains largely sealed.

In conclusion, this literature review informed the present study in two ways:

Firstly, it supported the urgency of the general research theme of the present study, as there is clearly still a lot to learn about corporate compliance and particularly in the context of regulated firms.

Secondly, the literature review helped to enhance the general theoretical sensibility of the researcher, who used the core concepts identified in the literature in order to develop questions for an interview guide.

The following chapter will outline the methodology used for the present research study.

# Chapter III - Methodology

*Systematic work wd be easy were it not for this confounded variation, which, however, is pleasant to me as a speculatist though odious to me as a systematist.*
(Darwin, 1850)

The above quotation from a letter that Charles Darwin wrote to his friend Sir Joseph D. Hooker to show his frustration over the many different variations he had discovered in the study of *cirripedia*[2] fossils is a vivid illustration of a core problem that all researchers share: How can one be certain that the samples one has taken are sufficient and the variations found within the samples are really significant? How many samples need to be collected before one leaves the field of speculation and enters the field of systematic research i.e. the field of science?
The study of fossils conducted by Darwin shows rather vividly how difficult this can be. A researcher may have discovered the fossils of an animal (e.g. *cirripedia*). These fossils are then the empirical database for any analysis and thus the foundation of any new knowledge that can be gained and any theory that might be developed. The fossils can be compared with each other in order to look for shared features and variables. If the researcher was lucky enough to have unearthed sufficient fossils to identify variables (e.g. different sizes and shapes) he will be able to categorise them into different groups and each group can be labelled differently (e.g. species, sub-species, etc.). But what can be concluded, if all of the fossils look slightly different? Which differences are the "*anchor points*" that can be used for categorisation of different groups and which differences are perhaps irrelevant (e.g. because they are just the signs of corrosion in the fossil remains)?
Surely, the more samples a researcher has available, the more often it can be seen which of the differences are re-occurring in the different fossil specimen and which ones are outliers. Therefore, it appears logical that a larger sample base enhances the chances that relevant variables are discovered. But in reality, a large sample size can be equally misleading. For example, even two thousand fossil remains of *cirripedia* attached to the same piece of rock might all belong to just one species. Analysing too many samples of the same kind could then be risky, as the researcher could be tempted to believe in the reliability of the observations made although there might be

[2] *Cirripedia* are an infraclass of barnacle.

other rocks with only very few *cirripedia* attached, which in fact belong to a different species. Consequently, only relying on the larger sample base the researcher might be tempted to conclude that the outliers on the second rock are discarded as irrelevant anomalies. Chances are that these few specimens actually belong to an undiscovered new species, but the researcher discards them as irrelevant outliers.
Another problem with a large sample size is that it will often times simply not be available. To use the same example, palaeontologists are often faced with the problem that the amount of fossils available to them are very limited and that researchers therefore have no choice, but to build on what they have at hand (Fischer & Steel, 2008). Sometimes no more than two or three fossils of a certain species have been found.
Which conclusion can be drawn, if the fossils of two or three specimens of a certain species differ in size and shape? Does this mean that each fossil relates to different sub-species? Or perhaps the difference occurs because one fossil relates to a female, the other to a male and the third one to a "crippled" specimen?
Ultimately, these questions have to be answered by the researcher´s own personal way of thinking. Every researcher has to decide how many and which samples he takes. The researcher has to conclude, whether enough samples have been studied and if the variables that have been identified are really relevant. Of course, the decisions that a researcher makes in order to derive his conclusions will later be subject to discussion and scrutiny of other experts in the same field of study.
It is therefore crucially important for every researcher to establish a clear way of thinking about the phenomena of interest (i.e. a clear method) and to use systematic technique and procedure for sampling and analysis (i.e. clear methodology). Otherwise the result of his ambitions will be hardly more than speculation, but surely not science.

This chapter lays out the method and methodology used for the present study and explains why these have been used and how they have guided the development of theory.

## General Research Design

Good research design should, according to Marshall (2016) address the following eight topics:

1. The overall genre and strategy,
2. the site selection,
3. the researcher´s entry role and ethics,
4. the method for data collection,
5. the strategy for data management,
6. the approach on data analysis,
7. trustworthiness and
8. a general timeline.

The main objectives of the present study are all related to a deeper understanding of how compliance behaviour works in regulated companies. The wider academic context of the present study is therefore the area of business-related sociology. As compliance behaviour within companies always ultimately relates to human actions, the "genre" of the study can be seen in the study of individual lived experiences. Performing in-depth interviews with relevant experts was the main strategy used.
The first and one of the most relevant decision for a researcher is to choose the setting in which she or he will place her or his enquiry (Marshall, 2016). In studies of social phenomena like compliance behaviour the choice of the setting can be seen as the first sampling. It would be impossible to study compliance behaviour in all different kinds of companies, industries and cultural environments. Therefore, the setting needs to be more limited. In the present study asset management companies in Germany and in the UK, have been selected as the setting for empirical enquiry. This selection was made for two main reasons:
Firstly, asset management companies in Germany and in the UK, are subject to a multitude of regulations and therefore relevant for a study of compliance behaviour within regulated companies. In addition, these companies are important for the financial system and for the overall economy of Germany and the UK, which makes a good understanding of compliance behaviour in the context of these firms even more relevant.

Secondly, asset management companies are legally required to have dedicated Compliance Officers, which naturally have good insight of the social phenomenon of interest (namely the compliance behaviour of the different stakeholders within and outside of these companies). Because the researcher himself was also working as a Compliance Officer within an asset management company he was well positioned to conduct interviews with other Compliance Officers in this industry.

In this context it is important to recognise the role of the researcher and to acknowledge that the presence of the researcher in the lives of the participants is fundamental to the methodology (Marshall, 2016). Choosing the setting of asset management companies and doing interviews with experienced Compliance Officers allowed the researcher to build on his own professional experience in this setting. Interviews have been conducted on "eyes level", meaning that the informants acknowledged the double-role of the researcher as a representative of the academia and as an associate Compliance Officer. On the one hand this was helpful to spark meaningful discussions during the interviews. On the other hand, this also means that the researcher was not completely free of own bias.

In order to manage the influence of personal bias reflective memos have been produced after every interview. These memos helped to identify potential bias and address it more openly during the data analysis. In addition to this preliminary research results have been presented at different academic conferences (e.g. at the 16th International Circle conference (2019) in Gloucestershire, the EuroMed conference (2016) in Warsaw and at the 12th International Circle conference (2015) in Szczecin)[3] in order to obtain critical feedback throughout the research process.

The method for data collection used in the present study was a series of in-depth interviews with very experienced compliance professionals at different asset management companies in Germany and the UK. Informants for the interview series were at first selected from the researcher´s own contact lists. Furthermore "snow-balling" was used and the informants were asked to suggest additional participants for the study.

[3] The researcher actively participated at these conferences with a presentation and with the submission of an abstract published in the conferences proceedings: (Zwerenz, 2015b, 2016; Zwerenz, Kaufmann, & Simpson, 2019). Additionally the researcher published an essay about reflective thinking during research at doctorate level in the International Journal and Cases (Zwerenz, 2015a).

The interviews were conducted either in a meeting or in some cases via phone and lasted at least 1 hour. All interviews have been recorded and transcribed for further analysis.

Grounded theory method ("GTM") techniques were used for data management and data analysis. The details about how GTM was used in the present study will be laid out below.

## Grounded Theory Method: An Overview

The following section will provide a short overview of grounded theory method and will show, why and how it was used in the present study.

"*Why should a researcher choose grounded theory method over other forms of descriptive or theory-building qualitative research? Grounded theory methodology has been around for a long time and provides a tried-and-true set of procedures for constructing theory from data. The procedure enables researchers to examine topics and related behaviours from many different angles – thus developing comprehensive explanations*."
(Strauss and Corbin (2015), 11)

Strauss and Corbin´s quote above encapsulates some of the main advantages that GTM provides:

- GTM has produced a significant amount of good and valuable research
- GTM provides a set of tested tools (mainly with regards to data analysis and coding)
- GTM allows the researcher to examine topics and related behaviours from different (and perhaps new) angles
- GTM helps to develop deeper understanding of such behaviours, which allows the development of comprehensive explanations

Grounded theory was first conceptualised by Glaser and Strauss (1967) in their work "*The discovery of Grounded Theory*", which was basically an attempt to provide a new method for qualitative research in the social science, opening a different view on data analysis. In its original concept GTM aims to provide explanations for social phenomena by "working backward" from data into theory (Marshall, 2016). In other words, GTM advocates that the researcher should not start with any hypothesis that he then tests against the data in order to verify it.
Glaser and Strauss originally introduced this radically different method in their book "The Discovery of Grounded Theory" (Glaser & Strauss, 1967). As suggested by Bryant and Charmaz (2012) Glaser and Strauss likely developed GTM as a methodology through analysing their own research decisions made in previous works (especially in relation to their empirical study "Awareness of Dying" (Glaser &

Strauss, 1965)). Based on these analysis Glaser and Strauss (1967) argued that, if sociologists would apply a traditional "bottom-down approach" to their research, they would risk becoming very doctrinaire towards testing and validating their pre-defined hypotheses. This kind of methodology is then prone to the risk of searching only for arguments to support the pre-determined hypotheses and researchers are more likely to overlook other relevant information in the data. In contrast to this, GTM advocates an open and explorative approach, which is designed to enable the "discovery" of theory directly in the data ("bottom-up approach").
While this approach was new to social science, other explorative research methods have a long tradition in different academic disciplines. The following example of an explorative research methodology in the field of biology illustrates some shared core characteristics with GTM. It also shows more generally, how explorative research is different from other research methods:

The research into deep-sea eco systems such as those found at "whale falls" was significantly influenced by explorative research. A "whale fall" is the sunken carcass of a dead whale. For a long time, it was unclear what happens to the dead remains of a whale after it has sunken to the bottom of the ocean. This changed, when in 1987 a deep-sea expedition led by Craig Smith accidentally discovered the dead remains of a whale 1,240 meters deep on the ocean floor. When Smith returned a year later for a proper study of the whale fall he discovered several unknown species feasting on the bones of the dead whale (Little, 2010). Finally, this discovery had inspired further research of whale falls and led to the discovery of an entirely new eco-system that lives and depends on dead whales sunken into the deep sea (Smith, Glover, Treude, Higgs, & Amon, 2015).

Instead of testing any pre-developed concepts or performing experiments, explorative researchers, such as Craig Smith, aim to develop new concepts and theories grounded in observations. The nature of this kind of research requires that the researcher sits calmly and quietly in his submarine, dives down to the dead whale again and again and simply observes very carefully what is going on. It is important that the researcher maintains an objective attitude towards his observations. The researcher therefore aims to limit his interference with the data to a minimum (he

would, for example try his best not to disturb any fish that scavenges at the whale carcass).
In their early work Glaser & Strauss advocated the same "objectivist" attitude in the field of social science:

"*The sociologist may begin the research with a partial framework of "local" concepts, designating a few principal or gross features of the structure and processes in the situations that he will study. For example, he knows before studying a hospital that there will be doctors, nurses, and aides, and wards and admission procedure. These concepts give him a beginning foothold on his research. Of course, he does not know the relevancy of these concepts to his problem – this problem must emerge – nor are they likely to become part of the core explanatory categories of his theory."*
(Glaser and Strauss (1967), 45)

The problem with a strict "objectivist" research approach in the field of social science is that the social scientist is almost always part of the social world he is studying. While the biologist diving in a submarine to the ocean floor will easily be able to detach himself from what is happening at the whale fall, this will be much more difficult for a social scientist who has to conduct interviews with other human beings. Naturally, the social scientist will influence the interview participants as they will start to think about the questions and follow-up questions that are imposed upon them. Simultaneously, the researcher will unavoidably bring some amount of his own personal views and opinions into the research setting and will thereby almost unavoidably influence the answers he will receive from the informants.
This problem was to some extent acknowledged by Strauss and Corbin (1990), who stipulated that theory should "evolve" from the data by the researcher´s interaction with the data. The Strauss and Corbin (1990) version of GTM caused a disagreement with Glaser, who had always advocated that theory should be "discovered" in the data. Despite this disagreement, both stayed connected by the shared idea that in order to allow theory to "evolve" or "to be discovered" the researcher must avoid "contaminating" the research product (Ramalho et al., 2015). In other words, although Strauss acknowledged more than Glaser that absolute objectivity is difficult to achieve in social research, both ultimately believed that an objective theory exists independently of the researcher.
Cathy Charmaz, a student of Glaser and Strauss went one step further, by arguing that GTM can also be applied from a different epistemological standpoint and

developed what is now known as “constructivist grounded theory” (Mills et al., 2006).

Constructivist grounded theory accepts that social science is largely dealing with an interpretive portrayal of the world and not with an exact picture of the real world (Charmaz, 1995). Constructivists understand that their data represents different perspectives of - rather than (directly) - the real world. Consequently, constructivists do admit that the information gathered is not an account of “the ultimate truth”, but rather just one side of a dice with multiple sides.

Constructivist GTM therefore advocates the active interfering of the researcher with his informants (and with the data) in order to see multiple perspectives of what is happing in “the real world”. Ultimately, and in contrast to the classical GTM research as advocated by Glaser or by Strauss, the constructivist GTM researcher has then to consider all these different perspectives (including his own) and “construct” a new picture of the social phenomenon. Irrespectively of this different epistemological standpoint Charmaz (2006) acknowledged that a constructivist grounded theory also follows an inductive approach and must prioritise data over other input.

Charmaz´s constructivist approach on GTM inspired and informed the choice of a suitable research method for the present study. The present study was designed to explore compliance behaviour in regulated companies, which fits well with a GTM approach. As the researcher is on the other hand also a Compliance Professional and as he has conducted in-depth interviews it was difficult to apply a strictly objective approach to GTM. Consequently, Charmaz´s constructivist approach to GTM was seen to be the best choice for the design of the present study.

## Research Philosophy

To achieve a good research design, researchers must ultimately choose a research paradigm, which reflects their own ontology about the nature of the problem. Accordingly, it must be decided if one believes that an objective and ultimate “truth” can be discovered or evolved from the data or if one believes that this is not possible. As outlined above, both Glaser and Strauss - despite their disagreement over whether theory should be “discovered” or should “evolve” from the data - ultimately believed that an objective theory exists in the data independently of the researcher himself (Ramalho et al., 2015). According to such a philosophy the personality, experience

and cultural background of the researcher do not matter. In other words, if two different persons work through the same set of data, they should both be able to "discover" or "evolve" the same theory.

In contrast, those who do not believe in the existence of such an objective reality and in an "ultimate truth" to be discovered automatically assume according to Guba and Lincoln (1994), a relativist ontological position. Relativists believe that theoretical concepts, such as truth, right or good are never objectively true, but must be understood relative to a specific paradigm, society or culture.

According to Mills et al. (2006) constructivism is a research paradigm that intrinsically denies the existence of an objective reality and instead takes a relativist position and emphasises the subjective interrelationship between the researcher and the informants in order to construct meaning. Therefore, constructivists do acknowledge that the researcher will unavoidably have a certain influence over the development of a theory. This is due to the fact that a researcher can never completely avoid viewing data from his distinct personal perspective, which is determined by his pre-existing knowledge, his experiences, cultural background and his personality. Thus, if two researchers work with the same set of data from a constructivist approach, they may potentially end up "discovering" or "evolving" two different theories, which would both be valid from their respective perspectives.

As stressed by Charmaz (2006), a constructivist approach on research regards both data and analysis as created from shared experiences and relationships with participants. Meaning is in fact made from the interrelationship between the researcher and the participant.

This string of arguments informed the present research, which was following a constructivist approach as advocated by Charmaz. Given that the researcher is also a professional working himself in the field of compliance it was difficult to be completely detached from the informants and the data. A relativistic ontological position and a constructivist approach were therefore more natural to assume for the purpose of the present study.

### Data Collection and Analysis in GTM

GTM advocates a form of purposive sampling known as "theoretical sampling". Charmaz (2006) described theoretical sampling as type of sampling used in GTM in order to develop the properties of an emerging category or theory. In GTM data

collection/generation and analysis is used in alternating sequences (see figure below). This process can be understood as an iterative cycle of induction and deduction based on constant data collection and comparison between results and discoveries in order to guide further data collection (Strauss & Corbin, 2015).
As a consequence of this iterative cycle of constant data collection and comparison between results, the development of any hypotheses ("anchor points") and potential variables, do not take place prior to data collection. Instead the researcher enters the field in an open-minded way and with an attitude that allows deep exploration of the social phenomenon subject to the enquiry. It is therefore logical that interview questions should be very open and should give little guidance to the informants. Otherwise the researcher would run the risk of limiting the discussion of topics that could potentially be relevant for the social phenomenon.
It is then the task of the researcher to define what the data is about. This process is known as "coding" in GTM (Charmaz, 2006). Codes are than categorised by selecting codes that have more significance or by abstracting common themes in several codes into an analytic concept (Charmaz, 2006). Ultimately, the categories can be developed into a grounded theory that explains the social phenomenon.
In GTM this cycle is continuously repeated until gathering more data reveals no new properties or additional theoretical insights about the emerging theory (Charmaz, 2006). This point is commonly referred to as "theoretical saturation".

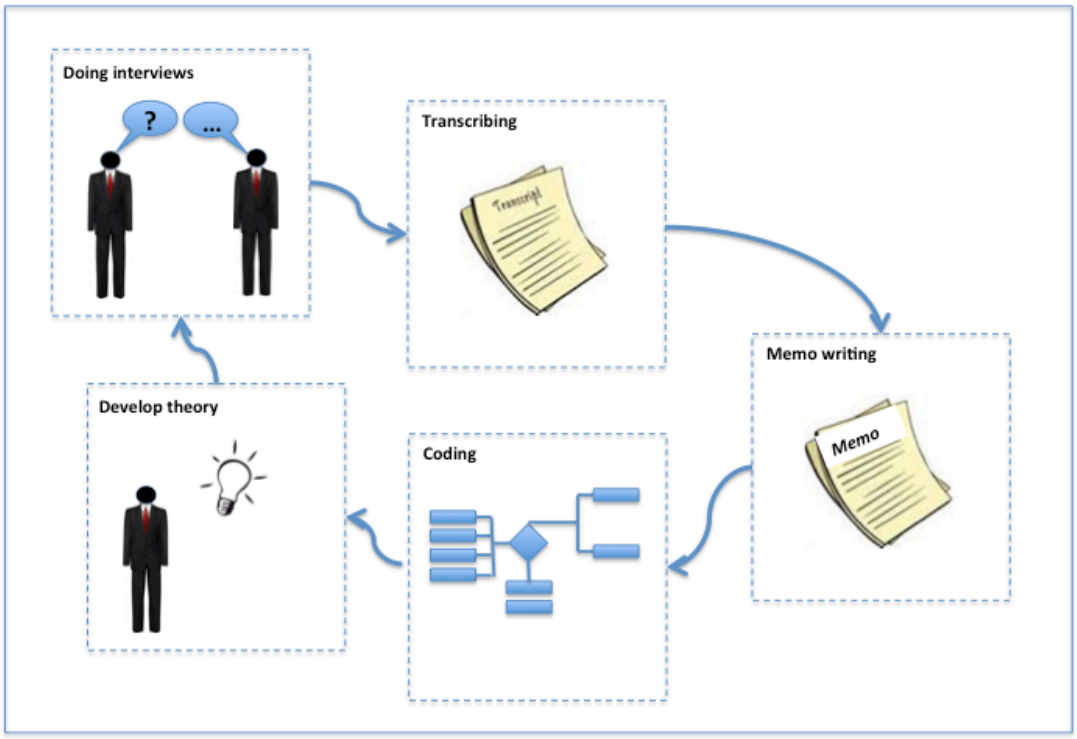


Fig. 6*: The Cyclical Process of Developing Grounded Theory.*

## Coding Strategies in GTM Research

Codes are labels for the text describing "what is happening?". The aim of coding data (e.g. interviews) is to engage in a more abstract interpretation and it is through coding that the conceptual abstraction of data and its reintegration as theory takes place (Holton, 2012). In other words, codes are for the social scientist, what unearthed fragments of a broken vessel are for an archaeologist. They are pieces that are carefully "excavated" out of the interview data with the aim of understanding how they fit together on a more abstract level.

GTM typically advocates the use of different coding techniques for different phases of data analysis. The coding process often begins with open coding, followed by focussed coding, axial coding and theoretical coding.

Open coding can provide a good starting point for the data analysis and can help to produce an initial list of themes that were important to the informants and are relevant to the social phenomenon of interest to the study. It can be done in different ways, for instance, coding word-by-word, line-by-line or incident-by-incident. In any case open coding forces the researcher to ask a set of abstract questions of the data (e.g. "What category does this incident indicate?" or "What is the main concern being faced by the informant?") and it is therefore very helpful to verify and saturate

emerging categories (Holton, 2012). Again, drawing comparisons with archaeologists, open coding could perhaps be understood as the actual process of excavating fragments of a broken vessel. After the fragments have been excavated the archaeologist might sort them nicely and number each of the fragments, but he does not yet know what the actual vessel looks like and if the fragments belong to just one or to multiple vessels.

After the first categories have emerged the social scientist can move to focussed coding, which means using the most significant or most frequent codes to synthesise and explain larger segments of data (Charmaz, 2006). Naturally, the process of focussed coding requires the researcher to make decisions about which of the initial codes he discovered are worth exploring further and which he will ignore during the next phases of data analysis. It is common practice for GTM researchers to write memos during this (and the later) stage of coding to support this decision-making process.

The archaeologist would likely face a similar challenge: After he has found enough fragments, he would also start to understand better how they interconnect, and he would gradually be able to develop an understanding of how the vessel once looked. The archaeologist would also need to discard certain fragments, if they cannot be connected with others.

If the social scientist has developed a good understanding of the main categories within the data, he might want to change his analytical perspective and might start to link categories to specific contexts. Coding for context is what Strauss called “axial coding” (Strauss & Corbin, 2015). Context is understood as a broad term. It relates, for example to specific events or circumstances, the action and interaction of a person to achieve a specific outcome, or to the consequences of a specific action (Strauss & Corbin, 2015). The purpose of axial coding is to relate categories to subcategories to a specific context in order to specify the properties and dimensions of each category (Charmaz, 2006). Finally, the researcher might move to theoretical coding. Theoretical coding mainly aims to specify possible relationships between main categories and to construct hypotheses (Charmaz, 2006).

Coding data in GTM is dynamically and permanently performed throughout the research. Coding always goes hand in hand with a constant comparison of the data in order to see if the data support and continue to support the emerging categories (Holton, 2012). The GTM researcher will therefore typically not start with data

collection (e.g. doing a series of interviews) and move to data analysis and coding after the data collection is completed. Instead the GTM researcher would rather collect data and analyse data in a continuous cycle until all categories are exhausted and no new properties or dimensions can be found. As Strauss and Corbin put it: "*Research is a continuous process of data collection, followed by analysis and memo writing, leading to new questions and more data collection*." Strauss and Corbin (2015), 240. Because of this cyclical process GTM researchers are also less dogmatic with regards to their research questions. The original research question is only seen as relevant in order to set the parameters of the study. New questions naturally arise through the course of the research, as the researcher begins to develop a better understanding of the social phenomenon and setting of the study. He may, for example, discover that a certain category is relevant in one specific context and he may wonder if it could also be relevant to another logically related context. In GTM these new questions are not ignored or saved for a later stage, but they are directly used in order to guide data collection in a more promising direction. This process of asking theoretical questions based on the initial data analysis and guiding data collection for the next cycle is referred to as "theoretical sampling" (Strauss & Corbin, 2015). Theoretical sampling supports the constant comparison of data during the coding process, as it allows the researcher for example, to compare categories that have emerged (or not emerged) in a specific context.

## The Use of GTM in the Present Study

The concept of a constructivist approach to GTM, as advocated by Charmaz, guided the use of GTM techniques throughout the data analysis of the present study. The reason to choose GTM was the researcher´s conviction that an explorative research methodology would provide the best insight into how corporate compliance is actually lived in reality in regulated companies and would be in line with the planned in-depth expert interviews. This decision was supported by previous research showing that GTM has provided very useful results in the study of compliance in the Atlantic fisheries (e.g. Grezelius (2003)), but had never been used to open the „black box“ of compliance behaviour in the finance industry.

As typical for GTM research, the present study followed the cyclical process for data generation/ collection, as shown in figure 6 above. A pilot study with three in-depth interviews was performed in the beginning in order to become more familiar with conducting interviews and in order to shape the topics and questions that have been addressed during the interviews.

The data collection phase was followed by ten additional in-depth interviews in order to explore the issues raised in the pilot study more deeply. Theoretical sampling was used to some extend in order to identify appropriate informants to address specific issues that came up during the data analysis. The detailed approach on sampling and on doing the in-depth interviews will be laid out in the section “*The use of interviews in the present study*” below.

Coding interview data is a particularly important aspect of GTM research and a rigorous approach to coding is crucial to achieve valid results Gill and Gill (2020) recently discussed the different meanings of the term “rigour” for qualitative research. They conclude that the term can either refer to “methodological thoroughness” (i.e. compliance-based perspective) or to the generalizability of the results and replicability of the method (i.e. criteria-based perspective). The authors suggest that a compliance-based perspective might be better to evaluate rigour of inductive research.

GTM is by nature an inductive research method, but the question arises, what are the key elements that have to be complied with in order to achieve rigour with grounded theory method?

Pryor (2009) has developed a model for how rigour can be enhanced in GTM research. This model suggests that coding should begin with open coding and axial

coding and should than move to selective coding in order to draft theory. Furthermore, coding should be performed after an initial literature review was conducted and the relevant literature should be integrated into theory. This is to ensure that the researcher has the required expert knowledge in the field of his enquiry in order to elicit relevant data, when coding at the level of data.

These key elements are reflected in the research design of the present study in the following manner: A literature review was performed to guide the research and to provide a "golden thread" and to develop theoretical sensibility (see section "The Role of the Literature Review" below). Additionally, the relevance of emerging theories and their practical implications could also be confirmed by the researcher´s personal expertise in the field (the researcher is also an experienced Compliance Officer).

The coding begun with open coding for incidents. However, this approach did not deliver good results and, subsequently all interviews were re-coded using line-by-line coding and pen and paper (see section "Re-evaluation" in Chapter V).

Focussed coding was done with the help of NVivo again, based on the results of the line-by-line coding. Finally, axial coding was used in order to link conditions, action-interaction and consequences of categories that had been identified during focussed coding. The development of initial codes up to core categories will be laid down in detail in Chapter VI – (Presentation of Findings).

Furthermore, the model developed by Pryor (2009) acknowledges that the use of techniques employed to reduce researchers´ preconceptions will also enhance the rigour of the research.

The present study employed the following methods to enhance rigour, when coding at the level of data: The researcher used memo writing as a tool for engagement in reflexive self-awareness (see section "Memo Writing" below). Furthermore, a good audit trail was developed to illustrate the emergence of codes into categories and theories in detail (see Chapter VI "Presentation of Findings").

Findings were confirmed throughout the field work, by discussions with the researcher´s supervisors and by presenting them at three different conferences (see section "General Research Design" above). These discussions also led the researcher to re-evaluate the findings from the initial coding of the date (see "Phase 3 – Re-evaluation" in Chapter V),

## The Role of the Literature Review

A lot of debate exists around the use of the literature review in GTM-related research studies (Dunne, 2011). Glaser and Strauss (1967) originally advocated for postponing the literature review until the end of the study. This idea was clearly driven by Glaser´s view that the researcher´s own preposition should be that of an "objective observer" in order not to influence the results of the research with his own ideas. It echoes the belief that any prior knowledge of the research area would potentially create unknown bias and the researcher would be likely to let himself be guided by what he had learned from the literature rather than from what he may actually observe.

More recent scholars admit that there are also some disadvantages to hosting interviews without having conducted a literature review. In the context of research work conducted as part of a formal doctorate programme, the student is usually expected to review the relevant literature in an early stage of his study. According to Stern (2012) it is therefore acceptable that, although it would be ideal to do the literature review after the construction of theory, a review prior to starting gathering data can sometimes be required.

In addition, it should be noted that a constructivist approach to GTM as advocated by Charmaz does not have the ambition that the researcher must remain the neutral observer. In fact, the constructivist approach to GTM admits that there is some unavoidable interference between the researcher and the informant. Therefore, doing a literature review before gathering the data is not as much in contrariety to such an approach, as it might be to Glaser´s traditional approach.

Furthermore, if a researcher is required to conduct the literature review before constructing theory, there are ways to manage any negative impact of the *a priori* knowledge onto the construction of theory. As suggested by Dunne (2011) "reflexivity" can be used as a mechanism to counteract the possible negative impact of early engagement with the literature.

The present study follows this approach. The literature review was performed at the beginning of the study in order to identify existing theoretical models in the field of this study to ensure that no similar study had already been conducted. Furthermore, the literature provided a "golden thread" that informed data generation and analysis.

### Memo Writing

Memo writing continuously supported the analytical process that led to the development of theory in this study. In contrast to field notes, which are usually taken in order to record observations and thoughts during the actual fieldwork, memos are usually produced to record thoughts during the process of coding and development of categories. In GTM research memo writing is *"[…] the methodological link, the distillation process, through which the researcher transforms data into theory."* (Lempert (2012), 245). Writing memos helps the researcher reflect on the data, the codes and the categories as well as on his own thoughts. Memos also help to structure emerging codes and categories and they can be helpful to steer theoretical sampling.

During the present study memos were written on the following occasions: Firstly, memos were written with pen and paper shortly after an interview was conducted. Secondly, memos were written on pen and paper throughout the whole research process in order to develop emerging categories.

An example of a memo written after an interview can be seen in appendix 8.

## The Use of Interviews

The present study is based on interview data. Recently, Atkins (2015) critiqued qualitative research that relies heavily on interview data. His critique mainly focuses on two main points: Firstly, he argues that interview data are data produced in the artificial setting of an interview and are therefore not data of the same quality, as data produced in a natural setting (e.g. participant observation). Secondly, he points out that it is unavoidable for a researcher to influence informant answers (i.e. the mere setting of an interview will likely already influence the way informants may answer a question) and that therefore informants could be caused to provide false or misleading information or they could be tempted to omit important information during an interview.

While these arguments are certainly valid, M. Hammersley (2017) argued against such a critique and makes the point that it is also necessary to recognise that selectiveness is a feature of all data production. Also, methods such as participant observation will require the researcher to decide which observations should be considered as relevant and which not. He must also decide when to end the observation.

Furthermore, Hammersley argues that while it is true that the researcher will unavoidably influence the informant´s potential answers by his own presence and by the way he asks the questions, this will not automatically render them inadequate or biased. There is no reason to assume that informants will automatically provide false answers or omit important information simply because they are influenced by the presence of the researcher. After all, they participate voluntarily in the interviews. There is also no reason to assume that the questions asked by the researcher will temp the informants to provide inaccurate or false answers in such a setting, as long as the researcher is asking objective questions in a polite manner, which are not considered disturbing to the informant.

Consequently, the present study has considered the aspect of voluntarily participation and it was ensured that questions were asked in a way that was not disturbing to the informants. Furthermore, interviews suited the constructivist approach of the study. Each informant presented a wealth of own thoughts and experiences, which helped to create a complete picture of “the black box” of corporate compliance.

## About the Selection of Interview Participants

The first important aspect in planning the interviews was the selection of interview participants. Clearly, interviews had to be conducted with experts who are familiar with what compliance behaviour looks in an asset management firm. According to Littig (2009) a difference can be made between (knowledgeable) lay people, specialists, experts and the elite according to the amount of knowledge and influence they have in a specific field. As illustrated below in figure 7, experts are the group with the most knowledge and power to influence a certain field. The most knowledgeable and influential experts form the elite. According to Welch, Marschan-Piekkari, Penttinen, and Tahvanainen (2002) an elite interviewee often occupies a senior or middle management position and enjoys functional responsibility in an area that enjoys high status.

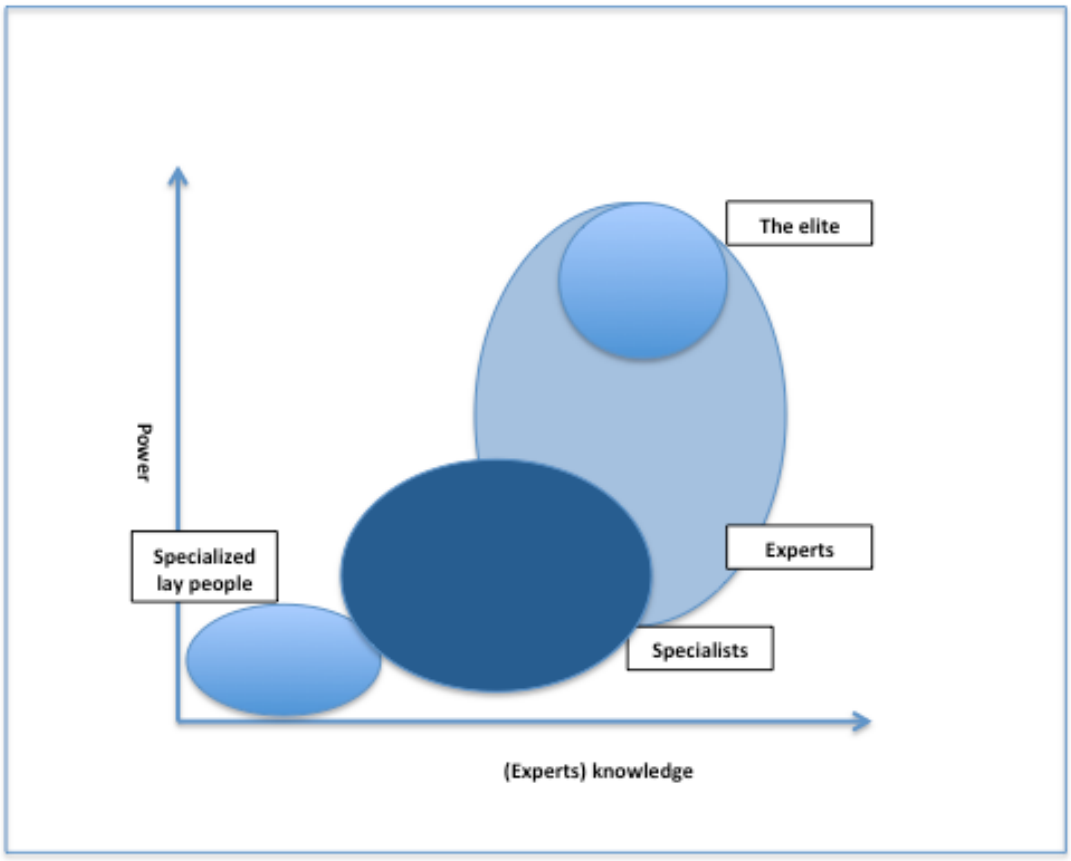


**Fig. 7: Differentiating Between Lay People, Experts and Elite according to Littig (2009), 108.**

While there exist many similarities between expert interviewees and elite interviewees, the elite differs in position, status and power to "ordinary experts" (Van Audenhove & Donders, 2019). Therefore, the knowledge that can be gained from expert interviews and elite interviews is different. In particular, experts often

have deep technical knowledge about a specific subject, but they may not have the same level of knowledge about processes, interactions, organisational constellations, decision-making and corporate culture, as the elite.

In the area of compliance behaviour within asset management firms all employees in various positions and departments, as well as other external stakeholders, such as consultants, auditors or regulators will have some expert knowledge of the subject. However, only a small group of senior compliance professionals with more than 10 years´ working experience and with managerial positions have the power to influence compliance behaviour directly (e.g. because their opinion is followed in their company or during industry association meetings) and can be regarded as an elite in this context.

Conducting interviews with informants of this elite had the advantage that these interviewees were able to share vast knowledge of actual processes (including history and changes), decision-making in the companies and of corporate culture (often with experiences relating to multiple different companies). Consequently, the empirical data gathered from these interviews provided a solid foundation for an exploration of the general research question, of what compliance behaviour actually looks within a regulated firm and how it is motivated.

Nonetheless, it must be admitted that this choice leads also to limitations within the data. Interviews with other stakeholders, such as those with employees of the firms that are not working directly in the Compliance department could have provided additional information about compliance behaviour within asset management companies. However, doing interviews with a large number of employees from different departments would have required a different methodology (e.g. survey) and was not suitable to explore the compliance behaviour of regulated asset management companies.

Consequently, the results of the present study are influenced by this choice and represent the “lived experience” of the top elite of Compliance experts, but not the views and experiences of every individual stakeholder within a company.

Lastly, it should be mentioned that, it was later decided to conduct three interviews with other relevant stakeholders (a Consultant, a Head of Legal and a Head of Risk Management) in addition to the interviews that were conducted with senior Compliance experts. Why this was decided and how it helped to improve the data quality will be laid out in detail in Chapter VI “Presentation of Findings”.

### About the Interview Questions

One difficulty in doing grounded theory research is the use of predetermined questionnaires. These are helpful for directing the interviews into the areas that have relevance to the research questions derived from a literature review. In their original work Glaser and Strauss (1967) advised that researchers should be agnostic to the existing literature in the area under study and should therefore not perform any kind of literature review before conducting interviews. Glaser´s view echoes the explorative nature of grounded theory research: Theory should emerge out of the empirical data in the course of an inductive analysis process and therefore it would be detrimental to this approach, if the research would enter the field with some *a priori* formulated concepts based on the literature.

However, as laid out above, later researchers disagreed with such a narrow interpretation and, for example, Dunne (2011) argues that research can still be "explorative", even though the researcher is not completely agnostic to the existing literature.

Due to the formal requirements of doctorate theses, the present study compromised between the formal requirement of performing a literature review in advance of the interviews - and the methodological requirement of beginning fieldwork with an open mind by conducting a literature review that outlined all relevant theoretical concepts, but without deducting a pre-determined hypothesis. The general research question, of what compliance behaviour actually looks like within a regulated firm and how it is motivated, guided the empirical research phase.

As no detailed research question had been deducted, and because conducting expert interviews without having any form of questionnaires is difficult, some more structure was needed in preparation for the interviews. This need for structure became even more urgent, as right from the offset, many interview participants were reluctant to participate in an interview without knowing anything about the topics and questions that should be addressed.

Consequently, in order to fulfil this need, an interview guide had to be developed to facilitate this requirement and to help with structuring the interviews.

The development of this interview guide had to take into account two critical factors: Firstly, as outlined above in detail GTM, is an inductive research method and therefore no detailed research questions had been deducted from the literature on which a structure could have been developed. Secondly, even though some structure

was needed, the interview guide should still be open enough not to limit the explorative nature of the interviews.
The literature review helped to identify two different epistemological approaches for corporate compliance research, both represented by a specific theoretical model. These two models were used in the following manner in order to develop two main questions, each with a set of sub-questions.

### *Question to Reveal What Motivates Compliance Behaviour*

The first question in the interview guide (*How is national and international law implemented in compliance related functions of regulated companies in the case of a German asset management company?*) was connected to the Lehman-Nielsen holistic compliance model. According to this model compliance behaviour is seen as exogenous to the research and the answer to the question depends on the following factors:

a) Motives (economic, social or normative)
b) Decision making
c) Decision implementing / company resources
d) Formal and informal institutions (with direct and indirect influence)

These four decisive factors were formulated into four open sub-questions in order to support question1 in the Interview Guide:

**Question1:** How is national and international law implemented in compliance-related functions of regulated companies in the case of a German/UK asset management company?

- **Sub-question A:** What motivates compliance behaviour within companies?
- **Sub-question B:** How do companies ensure they comply with relevant laws (what are the internal procedures and organisational measures)?
- **Sub-question C:** Which organisational measures and responsibilities exist in companies to identify new laws and regulations?
- **Sub-question D:** What are the relevant stakeholders and interactions within and without a company, which influence the compliance behaviour?

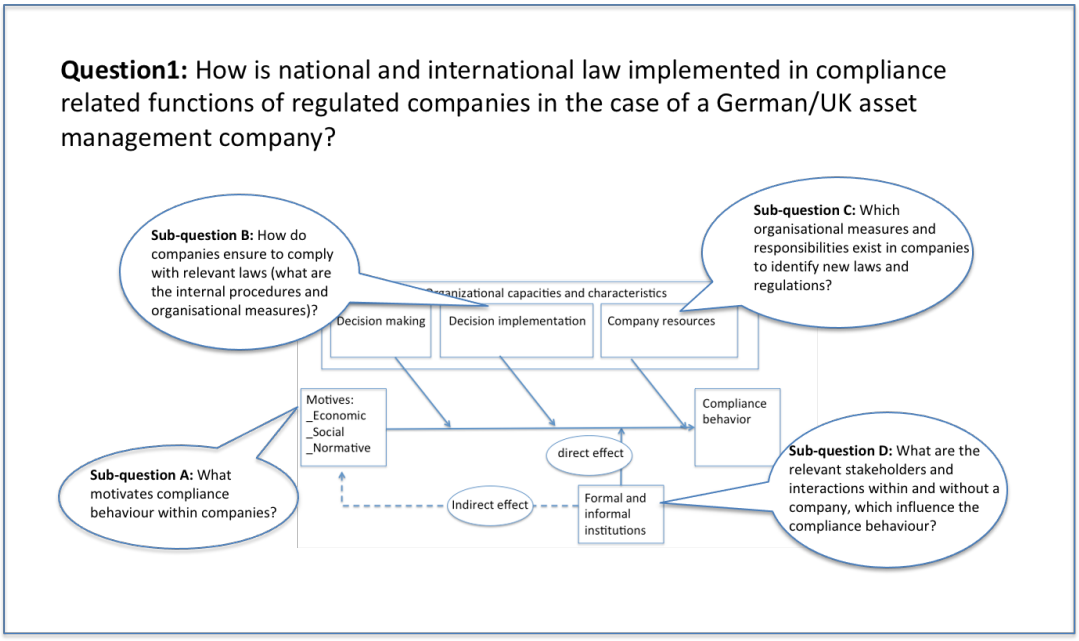


**Fig. 8: Illustration of How the Nielsen-Parker Holistic Compliance Model Informed Question 1.**

### *Questions to Reveal What Compliance Behaviour Looks Like*

The second question in the interview guide (*Does "compliance behaviour" change an organisation´s corporate culture at personal and organisational level and if so, how can these changes be conceptualised?*) was brought into connection with the process-oriented compliance model developed by Edelman and Talesh.[4] This model assumes an on-going exchange between the organisational field, the legal field and the regulatory field. This exchange determines how compliance behaviour will actually materialise in a company (or in an industry). The decisive factor is to therefore understand how compliance culture looks and how it will be influenced and changed. The following three open questions were thus developed in order to support question 2 in the Interview Guide:

**Question 2:** Does "compliance behaviour" change an organisation´s corporate culture at personal and organisational level and if so, how can these changes be conceptualised?

- **Sub-question A:** How does compliance culture look in a company?
- **Sub-question B:** What changes compliance culture?

[4] Note that the more advanced process-oriented compliance model developed by Root in 2018 was not yet published, when the interviews were conducted.

- **Sub-question C:** How do regulations influence compliance culture?

The complete interview guide can be seen in Appendix 1.

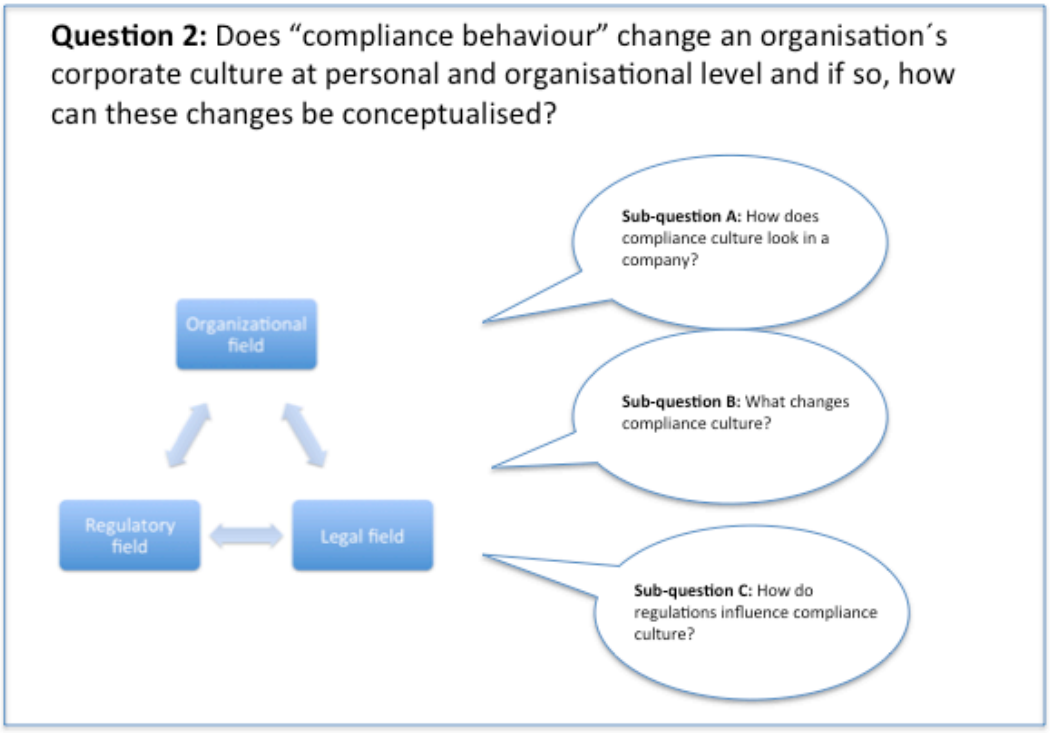


**Fig. 9: Illustration of How the Process-Oriented Compliance Model Informed Question 2.**

As the interviews were conducted with the help of an interview guide, they can be regarded as a form of "semi-structured interviews".
Interviews were, however, performed without slavish attachment to the questions presented in the interview guide. The researcher did not himself did not act as a "speaking questionnaire", but aimed to involve himself actively, by asking counter-questions and sometimes by adding his own thoughts. The interviews can therefore probably best be described as what Kvale (2007), 74 had portrayed as "discursive interviews". While it was desired to cover all of the questions in the interview guide and to explore each of these in depth by asking follow-up questions, the interviews were by no means limited to these questions. Whenever other topics emerged during the discussion, which seemed relevant either for the interviewer or for the interviewee, these were also followed up with questions. The interviews ended after all relevant questions and topics were exhaustively evaluated. As the interviews were performed in such a manner each lasted more than one hour and can probably be

characterised as what Marshall (2016), 147 labelled "*in-depth interviews*". An example of one interview transcript can be seen in appendix 7.

### About the Number of Interviews

Another important issue was deciding how many interviews would be enough to yield sufficient data to construct a substantive theory. Researchers may be tempted to argue that only a very high number of interviews would really suffice for this purpose. However, Glaser and Strauss emphasised that "quality" is more important than "quantity" of interviews:

"*[…] As we note in the next chapter on theoretical sampling, generation by comparative analysis requires a multitude of carefully selected cases, but the pressure is not on the sociologist to "know the whole field" or have all facts "from a careful random sample". His job is not to provide a perfect description of an area, but to develop a theory that accounts for much of the relevant behaviour*." Glaser and Strauss (1967), 30.

In theory, one single interview with a senior elite expert could be sufficient to understand a specific social phenomenon. In reality it is, however, clear that a very small number of interviews contains the risk of bias (e.g. another senior expert of the same elite could have a different view). It is therefore correct that a smaller number of interviews tend to deliver results that are less useful to draw general conclusions or to develop theory. However, at the same time it must also be considered that the quality of an interview with a member of an elite will likely provide a much better insight than an interview with a knowledgeable layperson, a specialist or other expert (not part of the elite). Consequently, the number of interviews should be larger with less knowledgeable and influential participants and can be smaller with more knowledgeable and influential participants.

The present study was therefore based on the interviews of multiple members of the same elite. Generally, it was ensured that at least as many interviews were conducted, as was necessary. This helped to yield rather repetitive information and thereby stabilise emerging codes and categories in order to reach a theoretical saturation of data.

Nevertheless, it must be pointed out that the number of interviews that informed the present study was also limited by the fact that on the one hand the elite of senior experts with knowledge of compliance behaviour within asset management firms in

Germany and the UK is a small elite. Secondly, it is very difficult for researchers to gain access to members of this elite.
Finally, 13 in-depth elite interviews were conducted that lasted around one hour each and thereby yielded a significant amount of spoken text that was transcribed and analysed (the 13 in-depth interviews yielded ca. 50.000 words transcripts for coding and analysis).

## Developing Theory

The purpose of any research is to generate useful new knowledge by the development of theory. The Oxford dictionary defines "theory" as: "*A supposition or a system of ideas intended to explain something, especially one based on general principles independent of the thing explained*." (OxfordDictionaries.com, 2017b)
In other words, a theory is a systematic and abstract way to explain how the new knowledge actually relates to a set of other ideas or to other knowledge. If, for example, an archaeologist has excavated enough pieces of a broken vessel to assemble them into the shape of a vase he can theorise that these pieces used to form a vase.
In social science, a theory is often an abstract concept or a hypothesis (a "supposition" or a "system" of ideas) that helps to explain a social phenomenon or behaviour. GTM offers a very unique perspective on theory and how it can be developed:

*"In grounded theory the analyst humbly allows the data to control him as much as humanly possible, by writing a theory for only what emerges through his skilled induction. The integration of his theory as it emerges through coding and sorting is his verification that the hypotheses and concepts fit and work and are relevant enough to suggest. They are not proven, they are theory." Glaser (1992), 87.*

This quote illustrates a core principle of GTM: In GTM theory is "inducted" out of data. Thus, GTM is fundamentally different to other research methods, which often begin with the development of a hypotheses based on a specific observation or based on a literature review, which is then "deducted" by testing it against empirical data. The differences in these two approaches can be illustrated again by comparison to archeology: If one archaeologist would enter a field-site with the specific idea of finding a vase (perhaps because he found a vase in a similar field-site), he will try to search specifically for those pieces that could belong to a broken vase (deductive approach). If another archeologist entered the same field-site without any pre-conceived idea about what he will find he would re-construct the pieces that he finds with an open mind, gaining a step by step understanding of how they could relate together and what kind of shape they might have had before they were broken (inductive approach). In the end, both archeologists may end up theorising that the pieces they find once belonged to a vase, but the way that led to this result was profoundly different.

The GTM-specific coding techniques laid out above all aim to support the inductive process of developing theory derived from the data. The codes that have been identified within the data are developed into categories. Categorisation in GTM is the analytic step of selecting certain codes that are more significant or that represent common themes on a more abstract level into an analytical concept (Charmaz, 2006). Consequently, categories comprise of different concepts and themes that have emerged in the data.
In a next step categories are linked together in order to establish their relationship to each other and to the social phenomenon of interest. Strauss and Corbin (2015) have suggested establishing links around categories (while engaged in axial coding) along the following lines:

1. Conditions (e.g. special circumstances or a specific situations),
2. Action-interaction (the informant´s reaction to an issue or event) and
3. Consequences (the results of this action-interaction).

By establishing these relations between categories, the researcher will be able to answer "why?", "where?", "how come?" and "when?" questions. This will allow him to develop a more abstract explanation. Eventually the researcher will be able to develop a core concept for his study. The core concept summarises the theory and provides a means for integration into other concepts (Strauss & Corbin, 2015). Developing theory in GTM can therefore be understood as an interpretive process that aims to condense data into more abstract levels of concepts. But, as Strauss & Corbin argue, there is more to it:

"*The most important aspect of theory is showing the relationship between concepts by (a) defining the main issue, event, or problem area under investigation as perceived by the participants; (b) explaining the potential context for action-interaction; (c) relating the action and interaction to the meaning given to problem, issue, or event and explaining how this action and interaction is subject to change with changes in context; and (d) relating the results or outcomes to action and interaction. Constructing theory necessitates that an idea be explored fully and considered from many different angles or perspectives*."
(Strauss and Corbin (2015), 62)

Theory in GTM research is therefore arguably much more than a simple supposition or a system of ideas intended to explain something. Theory in GTM aims to provide

a comprehensive and rich explanation of an idea that was explored fully and from different angles.

Drawing the analogy of the archaeologist who has excavated broken pieces that he had believes belong to a vase can again illustrate this point: Although the theory that the pieces belong to a vase does provide some new knowledge, this kind of knowledge is still very limited and dull. If the archaeologist would be able to provide additional contextual information to this theory (e.g. what this kind of vase was used for, or during which period such vases were produced) the knowledge would become much more colourful and useful. The same can be said about theory developed in the field of social science. Only when a theory meets with some qualitative criteria (e.g. the ones provided by Strauss and Corbin) will it be able to provide rich and useful new knowledge.

Another important aspect for determining the usefulness of the knowledge derived from a theory is the generalisability of the theory. GTM researchers traditionally differentiate between two types of theory according to their generalisability. The first type is called "substantive theory". A substantive theory is defined by Charmaz (2006), 189 as "*a theoretical interpretation or explanation of a delimited problem in a particular area, such as family relationships, formal organisations, or education*." A substantive theory is therefore a theory that anchors its core concept in a solid substantive ground (e.g. to the construction of culture within a specific type of organisations) and thereby limits its validity to a specific area.

The second type is called "formal theory". Charmaz (2006) defines formal theory at p. 187 as follows: "*a theoretical rendering of a generic issue or process that cuts across several substantive areas of study. The concepts of formal theory are abstract and general, and the theory specifies the links between these concepts.*" The application of a formal theory is, thus, not limited to a specific area but can be widely generalised (e.g. to the general construction of culture in multiple different areas). Both types of theory are equally valuable for the generation of knowledge, but they differentiate in their level of abstraction and validity.

Both types of theory allow "analytic generalisation". Analytic generalisation is a concept often used to explain the validity of case studies. Although GTM research is not the same as case study research, it shares to some extent the same challenges with regards to the generalisation of results: Case study research will typically investigate just one or a small number of cases. While the number of cases is usually

too small to allow statistical generalisation, it will enable the extension of the case study findings to situations outside of the original case study based on the relevance of similar theoretical concepts (Yin (2014), 237).

The example of a chemist conducting an experiment in a laboratory can illustrate the concept of analytical generalisation: Although the results of such an experiment have only been studied under controlled conditions in a laboratory, the chemist will nevertheless be able to generalise the findings of the experiment to any situation outside of the laboratory that shares the same theoretical concepts or principles (e.g. water will boil at 100° C in the laboratory and anywhere else under the same conditions).

Similarly, the generalisability of the results of a case study research (or of a GTM research) depends on the core anchor points of the main categories that are theorised rather than on the number of case studies investigated. If a theory is specific to the setting of a determined case than it can at least be generalised to any similar setting, whereas if the theory is very abstract and not limited to the boundaries of one specific case it can be widely generalized. In both situations, the number of actual cases studied is not decisive, the researcher will in any case be able to generate useful new knowledge with meaning beyond the actual field setting.

As will be outlined in detail in the following chapters, this study has developed substantive theory as the collection of data and their interpretation were focussed on a particular area, to explore compliance behaviour within asset management firms in Germany and the UK. The present study does not provide the scope to expand the developed substantive theory into a formal theory that would be applicable to a wider range of countries, company types or different cultural settings.

## Ethical Considerations

Ethical considerations are a relevant factor for social scientists, as Israel (2015), 2 phrases it:

"*Ethical behaviour helps protect individuals, communities and environments, and offers the potential to increase the sum of good in the world. As social scientists trying to make the world a better place we should avoid (or at least minimize) doing long-term, systematic harm to those individuals, communities and environments*."

In order to understand the purpose of ethical considerations one must reflect in a more abstract level, which aim a specific research project actually serves. The underlying aim of the present study is to better understand how corporate compliance actually works, which is hoped to improve the effectiveness of regulations and could perhaps even help to prevent future financial crises. On a more abstract level, it could be said that it is hoped that the outcome of this study could help to understand a specific aspect of a complex social mechanism that potentially causes problems in our society. This underlying aim of the present study is just another echo of what Israel describes as "t*o make the world a better place*".
In order to achieve this positive outcome, social scientists have to involve other people. By involving other people researchers assume a moral responsibility to protect the interest and integrity of these people. If a researcher would fail to protect the interest and integrity of other people involved in a research project the underlying aim to contribute to a better society could no longer be achieved. The present study relies greatly on the goodwill of experienced professionals to participate as informants during the interviews. The trust that these people have committed to the researcher must be recognised and it is the obligation of the researcher to ensure that the integrity and privacy of all participants is adequately honoured and protected. Researchers in the field of research ethics have recommended ways to mitigate potential risks for participants by informing them of the project and obtaining their "informed consent" (Israel, 2015). Conducting research based on voluntary and informed consent also aligns with the University of Gloucestershire's Handbook on Research Ethics. Therefore, the present study was guided by this principle. All research participants were provided with a written "Declaration of Consent" prior to an interview (see appendix 2). This declaration included detailed information about the background and the purpose of the interview and the research project. Furthermore, informants were provided with detailed information about audio

recordings of the interviews (e.g. how long recordings would be stored) and were asked to express their consent to participate in the study in writing.
As an additional measure and to protect the privacy of all participants, no names of participants or of companies have been disclosed in the present study. Acronyms such as "informant 1" have been used instead of real names. In order to respect the integrity of all participants, great care was taken to ensure that all quotations made are accurate and not out of context.
However, even researchers who insist on basing their work on informed consent can, according to Malone (2003), not completely overcome (1) complications arising from conducting research in their own professional area, (2) coercion and resistance, (3) institutional power and relationships and (4) the myths of confidentiality and anonymity. These four challenges have been considered in the following manner:
The first challenge for the present study relates to the fact that the researcher is himself an experienced compliance professional and his interview participants are also experienced compliance professionals. The method of "snow-balling" was used to gain access to these experts. This means that those who were willing to participate in the study were asked to act as "gate openers" and suggest other potential participants out of their own networks. Consequently, it cannot be completely excluded that some of the participants that had been contacted by their colleagues with the suggestion of participating in the study did so, because they felt, if they would not do so this could reflect negatively on their professional relationship with these colleagues. Given that none of the participants were asked to nominate any of their own employees to participate, and because participation was still completely voluntary, it can, however be argued that this fact did not do much harm to any participant (none of the participants was in any dependency to any other).
The next challenge for the present study was that (particularly during the later interview phase) the researcher had started to develop his own ideas and concepts and consequently, he asked questions and proposed ideas to the participants that could have created some coercion to steer the interview in a particular direction. This problem was dealt with in two ways: Firstly, the researcher continued writing memos and reflecting on each interview in order to try his best to detect his own bias. Secondly, all interviews were conducted in a respectful manner and the researcher avoided pressuring any participant by saying something like "XYZ had a completely different view when I discussed this issue with her".

Institutional power and relationship only played a minor role in the present study. However, it cannot be completely excluded that some participants did feel enthralled by the idea that the researcher was in a position to speak to a lot of their peers in the industry and this could have caused some resistance (or changes) to the information that they had been willing to provide during the interviews. Building any pressure was avoided during the interviews in order not to obtain information that the participants did not feel comfortable disclosing freely. The challenge that consequently some informants might not have disclosed all information that may have been relevant was overcome by the fact that interviews with multiple participants were conducted, until the emerging concepts were exhausted by repeating information from different participants.

Finally, it must be acknowledged that if we follow the line of arguments presented by Malone (2003), there is no such thing as "informed consent". This is the case, as even though participants in qualitative studies are informed in advance of the purpose of the interview and the background of the research project, it is still unlikely that the informants can truly and fully understand what will happen with the information that they have provided in an interview. Qualitative research – and in particular research conducted using grounded theory method – is often not a straight process leading simply from point A to point B. Furthermore, such research projects tend to go in circles, and it is not uncommon that they end up in an area that even the researcher did not anticipate. Nevertheless, the tool of "informed consent" is an important one and for the present study it was ensured as much as possible that all participants were informed about the purpose of the research project and the methodology used to analyse the interview data. Lastly, the names of the participants have been anonymised and are only known in full by the researcher. This will also help to prevent any unintended harm for any participant.

## Chapter Summary

The present chapter laid out in detail the method and the methodological approach used for the present study.

The main objectives of the study are all related to a deeper understanding of how compliance behaviour works in regulated companies. The wider academic context of the present study is therefore the area of business-related sociology.

The study is based on a series of 13 in-depth interviews, mainly with members of the elite of compliance professionals in the area of asset management in Germany and the UK. These interviews were conducted in a semi-structured manner with an interview guide that was informed by the literature review but presented in a very open manner in order to allow the interviews to adopt an explorative character. All interviews were transcribed, yielding ca. 50.000 words for coding and analysis. The coding and analysis of data followed a constructivist approach on grounded theory, as advocated by Charmaz. As typical for grounded theory research, conducting interviews and transcribing and coding data, were performed in an alternating process throughout the time of empirical research and until theoretical saturation became visible by repeating codes and categories. Memo writing was used as an instrument for self-reflection and in order to help developing emerging categories and theories. The details of this process will be laid out later in chapter V.

Before the findings are presented, the following chapter IV will first help the reader to get a better understanding of the complex business context of this study.

# Chapter IV - Context

*"Most social acts have to be understood in their setting, and lose meaning if isolated. No error in thinking about social facts is more serious than the failure to see their place and function." (Asch (1952) at. P. 61)*

Asch, who is famous for his experimental studies on the influence of social pressure, emphasised the importance of understanding social behaviour in its original context, as it will otherwise lose meaning. Clearly, the behaviour shown by a teacher to his students cannot tell us much about his behaviour as a car driver.

The general theme of the present study is the exploration of corporate compliance behaviour. The data used for this study are in-depth interviews with members of the elite of compliance professionals within the asset management industry in Germany and the UK.

As the typical reader of this study cannot be expected to be familiar with the peculiarities of the asset management business, it is necessary to explain the context of the present study more in detail before presenting the actual findings. Such an understanding of the context is required to better understanding of the results.

The following chapter will provide an overview of this special industry and the general regulatory framework that has to be adhered to by the relevant companies.

## Definition of "Asset Management"

According to the OxfordDictionaries.com (2017a) "asset management" (also referred to as "investment management") relates to "*the active management of assets in order to optimise return on investment companies, which are specialized in the management of financial investments*.". In other words, asset management is the business of investing money by actively buying or selling assets (e.g. listed securities, private debt, real estate or any other assets) in order to make a profit for the investor. Asset management companies collect money from multiple individual clients ("the investors"). The money collected from the investors is then pooled into collective investment schemes, such as mutual funds, pension funds or similar vehicles. In contrast to banks, asset management companies must separate the money managed within a collective investment scheme from their own proprietary money. The actual money is therefore held on the account of a separate depositary bank (see diagram).

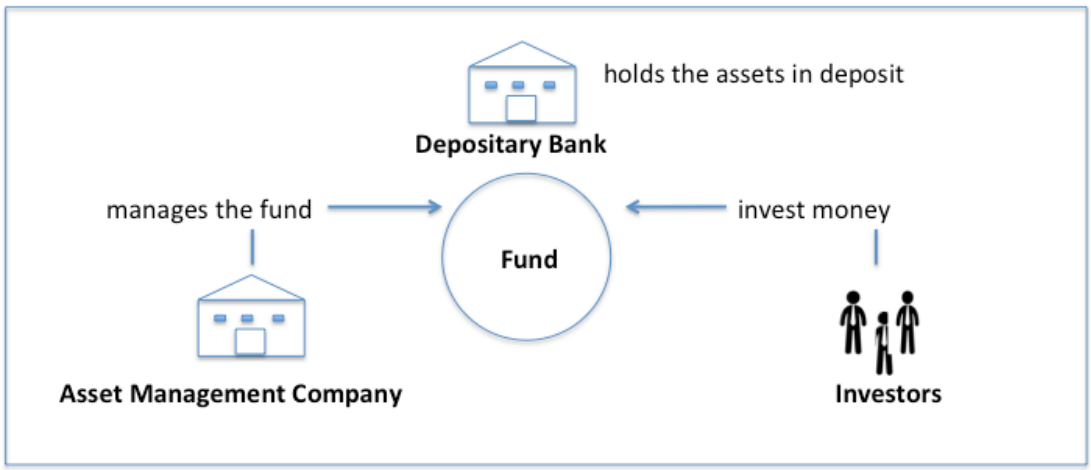


**Fig. 10***: The Relationship Between the Asset Management Company, the Depositary Bank and the Investors.*

Asset management companies predominantly generate profit by charging a fee to their investors for the service of investing money. In doing so asset management companies play an important role as financial intermediaries in the capital markets. Typically, asset management companies specialise into "active" or "passive" management strategies. Active asset managers will make "active" investment decisions ("stock picking") in order to outperform a given benchmark (e.g. an index, such as the S&P 500 or the DAX), while passive managers will simply reproduce a given benchmark without making active investment decisions in order to avoid deviations from the benchmark ("index tracking").

Regardless of their investment strategy, all asset management companies owe a fiduciary duty to the investors that have entrusted them with their money. Consequently, asset management companies are strictly regulated in the UK and in Germany and much like a bank they need to obtain licences from the regulator before they are authorised to conduct their business.

## Different Types of Asset Management Companies

Asset management companies in Europe must be authorised by a competent authority (e.g. by the BaFin in Germany or by the FCA in the UK) with a special licence in order to conduct their business. There are three European regulatory regimes (all have been transformed into local laws within all member states) under which asset management firms can be licenced.

First and foremost an asset management company can obtain a licence under the Undertakings for Collective Investment in Transferable Securities Directive 2009/65/EC ("UCITS directive"). Firms licenced as UCITS management companies are authorised to set-up, manage and distribute mutual funds. A mutual fund is a pool of assets, which is separate from the money of the management company and which is offered as an investment product to the general public.

Secondly, an asset management company can obtain a licence under the Alternative Investment Fund Managers Directive 2011/61/EU ("AIFM directive"). Firms licenced as AIFM management companies are authorised to set-up, manage and distribute alternative investment funds, such as hedge funds, private equity funds or real-estate funds. These funds are therefore generally allowed to invest in complex and illiquid securities in which a UCITS fund could not invest and are therefore not always offered to the general public. It should be noted that one category of alternative funds, the "special alternative fund", is frequently used in Germany to offer large institutional investors a special alternative fund, which can be tailored to their individual needs.

Thirdly, an asset management company can obtain a licence under the Markets in Financial Instruments Directive 2004/39/EC ("MiFID directive"). Firms licenced as MiFID management companies are not authorised to set up funds by themselves. They are only authorised to provide either individual portfolio management of segregated accounts or investment advisory services. This means that these firms can either act as delegated portfolio managers for an AIF or UCITS fund set up by an

authorised AIFM or UCITS management company, or they can manage individual portfolios of their clients, which are segregated accounts and not funds. Firms authorised as a UCITS or AIFM Management Company, on the other hand, can provide individual portfolio management as an ancillary service and do not require an additional MiFID-licence.

Most of the larger asset management companies in the UK and Germany are authorised as both a UCITS and AIFM Management Company (e.g. Allianz Global Investors or Schroeders). However, some large firms specialise in individual portfolio management and advisory services and operate exclusively under a MiFID licence (e.g. PIMCO).

## The Asset Management Industry in Germany and in the UK

The number of assets held under management by asset management companies can illustrate the size of the asset management industry. According to numbers calculated by the industry associations in the UK and in Germany in 2016, assets under management had reached a total amount of more than 1,000 billion GPB in the UK and 2,908 billion Euro in Germany (see figures below).


**Fig. 11***: Assets Under Management of German Asset Management Companies Since 2007 (BVI, 2017).*

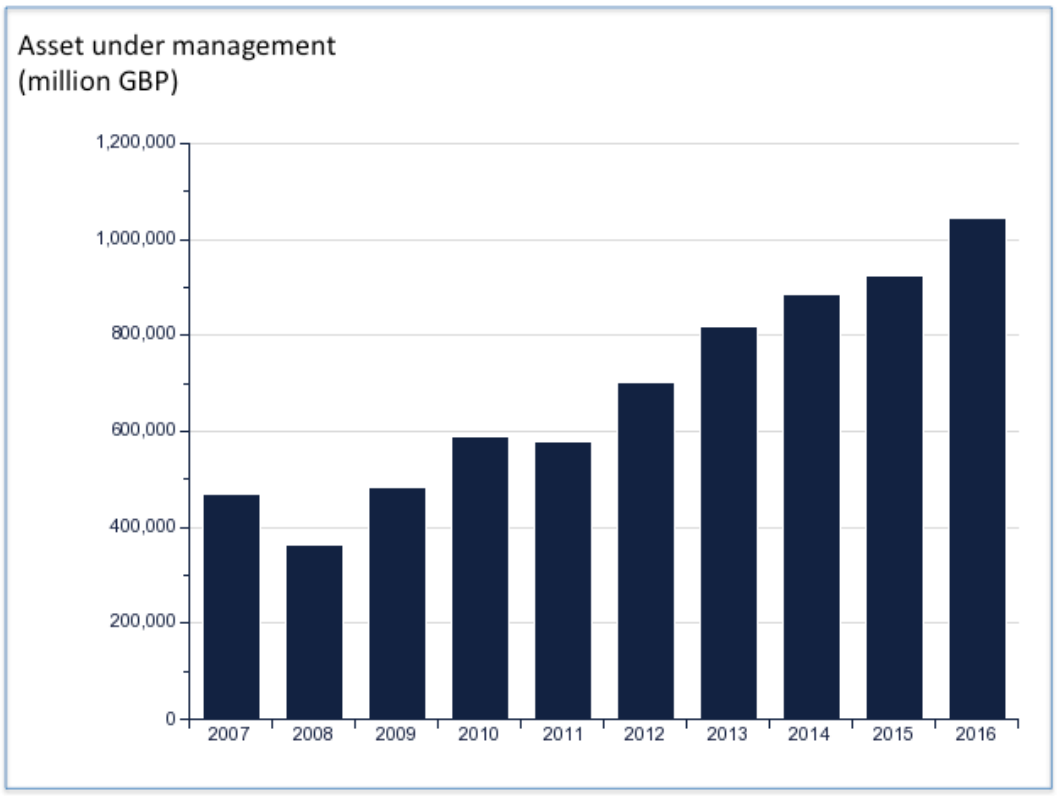


**Fig. 12***: Assets Under Management of UK Asset Management Companies Since 2007 (IA, 2017).*

These numbers illustrate the significant importance of the asset management industry as financial intermediaries for the capital markets in the UK and in Germany. Large parts of these moneys are invested in stock-listed securities, such as equities and corporate bonds. Asset management companies thereby provide the capital to stock-listed companies that these need in order to operate and grow their business.

## An Overview of Regulatory Requirements

Given their importance to the capital market and because they are entrusted with the fiduciary duty to manage the wealth of their clients, asset management firms are highly regulated. As these requirements stem from the three aforementioned European Directives (AIFMD, UCITS and MiFID) the actual requirements are also fairly similar in the UK, Germany and in the rest of the European Union.
The harmonisation of these regimes allows asset management companies which are authorised in one European member state to conduct business under the same licence within another European member state without the need to obtain another licence. A German asset manager with an AIFMD licence can, for example, obtain a simplified approval from the Financial Conduct Authority to "passport" its asset management services into the UK and vice versa. It is common practice for all larger European asset management companies to make use of this possibility.
The problem with this business practice is that one company can become subject to supervision by multiple regulators (e.g. by the BaFin and by the FCA). In this case the home state regulator of a firm is always responsible for supervision of the organisational requirements of the firm, while the host state regulator supervises the conduct of business within the host state.

## Organisational Requirements

Organisations have to be evaluated by the home state regulator in order to obtain a licence to do business. The organisational requirements of an asset management company authorised under AIFMD, UCITS or MiFID are fairly similar. Some of the core organisational requirements of an AIFMD licensed asset management company shall be used to illustrate what these requirements entail in practise:

- An AIFMD authorised company must provide for a minimum capital (e.g. initial capital of 125.000 Euro for an asset management company that intends to manage external funds).[5]
- The company must maintain certain compulsory company departments (e.g. risk management[6], compliance department[7] and internal audit[8]).

[5] See Art. 9 AIFMD (Directive 2011/61/EU).
[6] See Art. 15, AIFMD (Directive 2011/61/EU).
[7] See AT 4.4.2 MaRisk (BaFin Circular from 2012) for Germany and SYSC 6,1,3 of the FCA Handbook for the UK.
[8] See AT 4.4.3 MaRisk (BaFin Circular from 2012) for Germany and SYSC 6.2.1 of the FCA Handbook for the UK.

- The company must fulfil certain transparency requirements (e.g. an annual report must be provided to the responsible home state regulator and upon request to all investors).[9]
- Furthermore, other requirements regarding the organisation of the business must be met (e.g. compulsory rules for managing of conflicts of interest[10] including personal account dealing rules for employees[11]).

## Conduct Requirements

Conduct requirements govern the actual business behaviour and are monitored by the host state regulator. These requirements must be adhered to by an authorised asset management company in addition to the aforementioned organisational requirements.

Conduct requirements stem from various legal sources. Examples of these conduct requirements include inter alia:

- General market rules (e.g. the prohibition of market manipulation or insider dealing),[12]
- specific requirements to prevent money laundering and terrorism financing,[13]
- specific requirements to protect personal data[14] or
- specific requirements to ensure corporate socially responsible investments.[15]

Furthermore, the host state regulators may sometimes implement specific local requirements. Such local requirements are, for example, the FCA´s requirements for senior managers in relevant positions.[16] There is no comparable requirement in Germany, established by BaFin.

[9] See Art. 22 AIFMD (Directive 2011/61/EU).
[10] See Art. 14 AIFMD (Directive 2011/61/EU).
[11] See BT 2 MaComp (BaFin Circular from 2018) for Germany and COB 7.13 of the FCA Handbook for the UK.
[12] For example, determined by the European Market Abuse Regulation (Regulation 596/2014/EU).
[13] For example, determines by the Germany Anti-Money Laundering Act.
[14] For example, determined by the General Data Protection Regulation (Regulation 2016/679/EU).
[15] For example, determined by the European Corporate Social Responsibility Directive (Directive 2014/95/EU).
[16] See the FCA´s Senior Managers and Certification Regime from 2015.

Another example can be seen in the requirements for the distribution of products, which differ in the UK and in Germany (specifically the principle-based requirement "to treat clients fairly"[17] does not exist in this form in Germany).
Consequently, authorised asset management companies in Germany and in the UK have to comply with a variety of different organisational and conduct requirements, which stem from different legal sources.

[17] See PRIN 2.1 of the FCA Handbook.

## The Compliance Officer – A Brief History

In order to manage compliance with all of the aforementioned requirements, asset management companies will typically hire a dedicated Compliance Officer.
As explained by informant 2 during an interview, the role of the Compliance Officer was historically not mandatory for German asset management companies. It only became mandatory, when the European UCITS IV directive (EU directive 2009/65/EG) was transformed into law in Germany in 2011 with an amendment of the old German Investment Law from 2007 and the subsequent update of the "minimum standards for risk management (MaRisk)" by BaFin in 2012. Under this regime asset management companies were obliged to adhere to the standards, as outlined in § 9a InvG and as specified further in the MaRisk. The MaRisk stipulated for the first time that every relevant firm must have a dedicated compliance function, which is responsible for "*working towards implementing effective standards to ensure and to control that the firm is compliant with all essential regulatory requirements*" (AT 4.4.2 MaRisk from 2012).
It should be noted that it had already been compulsory for banks to have a dedicated compliance function for some time. And it should further be mentioned that many German asset management firms already operated already compliance functions on a best effort basis, before it became legally mandatory to do so.
However, this historical development is an important remark to understand the self-view of Compliance Officers within German asset management firms. It means on the one hand that the regulator has given special importance to the Compliance Officers and it means on the other hand the profession "Compliance Officer" is still relatively young within the asset management industry in Germany (note that UK-based asset managers have a longer tradition of mandatory Compliance Officers).
As outlined above, many firms that suddenly needed to build up a compliance function used existing resources within their legal departments in order to "clone" a compliance department. Informant 2 noted: "[…] *and so the junior-partner within the legal department became finally the one who gained significant importance and became equal with the Head of Risk Management and the Head of Audit – even in terms of salary".*
The next step in the development of the compliance function in Germany was to define its role within the organisation. An important difference of the role of the compliance function compared with the legal department is that the compliance

function should also “control” the effective standards implemented to comply with the law. This element of “controlling” means that the compliance function cannot simply provide advice on what should be done and what should not but is obliged to control whether the advised measures are really effective. This is quite different to the role of a traditional legal department, which was limited to the provision of advice and would never have the power, the resources or the mind-set to perform any kind of controls.

While this element was clear from the very beginning, what wasn´t clearly defined was, what these “essential regulatory requirements” are and how the newly established compliance function should actually perform its controls. It was up to the Compliance Officers to determine the “what” and the “how”.

## Chapter Summary

This chapter outlined what asset management companies are, which different types exist and why they are relevant to the overall economy in the UK and Germany. Asset management companies collect money from investors, which they hold on trust and invest it by buying and selling securities in order to generate a profit for the investors. The asset management companies themselves earn money by charging a fee to the investors. Asset management companies are often specialised in either investing money "actively" through "stock picking" or "passively" by building portfolios to replicate large financial indices such as the DAX. Such asset management firms are called "active" or "passive" asset managers.
Furthermore, asset management companies require a special licence that needs to be obtained by the respective regulator in order to operate their business. They can acquire one or multiple of the following licences:

- Firms licenced as UCITS management companies are authorised to set up, manage and distribute mutual funds.
- Firms licenced as AIFM management companies are authorised to set up, manage and distribute alternative investment funds, such as hedge funds, private equity funds or real-estate funds.
- Firms licenced as MiFID management companies are not authorised to set up funds by themselves. They are only authorised to provide either individual portfolio management of segregated accounts or investment advisory services.

In order to obtain such a licence, a firm must demonstrate permanent compliance with a multitude of organisational and conduct related legal requirements. It can therefore be concluded that asset management companies operate within a highly regulated industry. As a result, asset management companies have started to hire internal compliance departments, which help them adhere to all relevant requirements.
Nowadays asset management companies in the UK and in Germany are also legally required to hire a dedicated Compliance Officer.

The in-depth interviews conducted for the present study were mostly performed with such professional Compliance Officers. The following chapter will outline the performance and the results of these interviews in detail.

# Chapter V – Data Collection and Analysis

*No man burdens his mind with small matters unless he has some very good reason for doing so. (Doyle & Goodenough, 1985)*

One challenge of grounded theory research is to work backward and induct hypotheses from the data. Consequently, rather than simply subsume answers under a set of questions, the development of a grounded theory requires that the researcher "burdens his mind with small matters" and focusses his enquiry more on the data themselves in order to induct new hypotheses and construct new theory. Although, this seems sometimes counter-intuitive, it is the only way to ensure that a new theory is "grounded" in the data, rather than "forced" from the data in order to satisfy a specific question.

While the previous chapters have outlined the general methodological approach used for the present study, as well as the context in which this study took place, the following chapter aims to provide a detailed overview of how this approach was used for collection and data analysis in concrete terms. The study was conducted in three broadly distinct phases, which will all be explained in detail in this chapter.

The actual findings will be laid out in the following chapter.

## Phase 1 – Pilot Phase

The first phase of the empirical data collection served as a pilot study and had the following aims:

- To develop and test an interview guide;
- to allow the researcher to get some initial experience in conducting interviews;
- to develop initial codes and categories and
- to locate further relevant interview participants ("snow-balling").

The below section will provide more details about how participants have been selected for this initial phase, how the interviews have been conducted and which findings were made during phase 1.

### About the Interview Participants in Phase 1

Phase 1 was designed to "test the waters" and to prepare for the second phase. A good mix of informants, all experienced professionals working as department leaders within the compliance departments of asset management companies, were therefore selected. The experience in the field of compliance ranged from 10 - 30 years. Two of the participants were male and one was female. Two were from Germany and one from the UK.

One of the key problems of conducting interviews with elites who are leaders or experts in a community, is obtaining access to interviewees (Kvale (2007), 70). These people belong to a closed community and are usually very unwilling to participate in research projects. This is especially true for Compliance Officers working in a senior position, as they do not see any personal advantage and are afraid that someone could have a bad intent (e.g. someone could use a research project as an excuse to gain information for a negative newspaper article). This is probably the reason, why up until now no comparable studies using in-depth interviews with Compliance Officers within the asset management industry exists. The only studies that use empirical data about Compliance Officers are quantitative studies, which collect their data with very anonymous surveys (see for example Seidenglanz and Lopper (2016).

Access to this closed community was only possible, due to the fact that the researcher is himself a senior Compliance Officer at an asset management firm and is therefore himself part of this closed elite and because the participants were guaranteed that their names and the names of their companies will not be disclosed.

The three participants in phase 1 were all part of the researcher´s personal network and were therefore accessible as participants for this study.
In order to gain access to further relevant informants the researcher asked each of the participants, if they would be willing to refer him to other senior professionals within their individual professional networks ("snow balling"). This strategy was successful, as nearly all of the participants during phase 2 have become accessible to the researcher in this manner.

### About the Interviews in Phase 1

As outlined in detail in the chapter "Methodology" the present study is based on empirical data collected during in-depth interviews with industry experts who are part of an elite of compliance professionals. The interviews were conducted as semi-structured interviews, using an Interview Guide that was developed after the literature review.
For ethical considerations, all interviewees were informed about the purpose of the interview and were asked to consent for the interviews being recorded. The ethical considerations made in this regard are laid out in detail in chapter III under the heading "Ethical Considerations". All participants were provided with a written notice explaining the background of the research project (see Appendix 2 - Declaration of Consent). As stated above, it was guaranteed to all participants that their names and the names of their companies would not be disclosed. All but one participant agreed to having their interviews recorded. The recorded interviews were later transcribed for further data analysis. The one interview that was not being recorded was transcribed based on the written notes made during the interview.

### Data Analysis and Development of Categories in Phase 1

As laid out in chapter III, data collection and analysis took place in alternating sequences. During phase 1 all interview transcripts were coded incident-to-incident. Coding incident-to-incident is a form of open coding used in grounded theory. Charmaz (2006) at p. 53 describes this coding methodology as a "*close cousin to line-by-line coding*". Coding incident-to-incident means identifying incidents in the data and comparing them with other incidents in order to conceptualise these codes into categories. Incidents were identified by asking theoretical questions, such as

"what is the issue for the informant?" or "what appears to be important for the informant?". For example, one issue for the informants was that they would need to develop methods to constantly learn about relevant changes in the regulation that are relevant for their firm. Therefore, one incident was defined as "How firms learn about new regulation".

Coding was supported by the use of the NVivo software. NVivo supported the incident-by-incident coding in two ways: Firstly, it was used to mark all text sections within all transcripts that relate to a specific incident (see figure below).

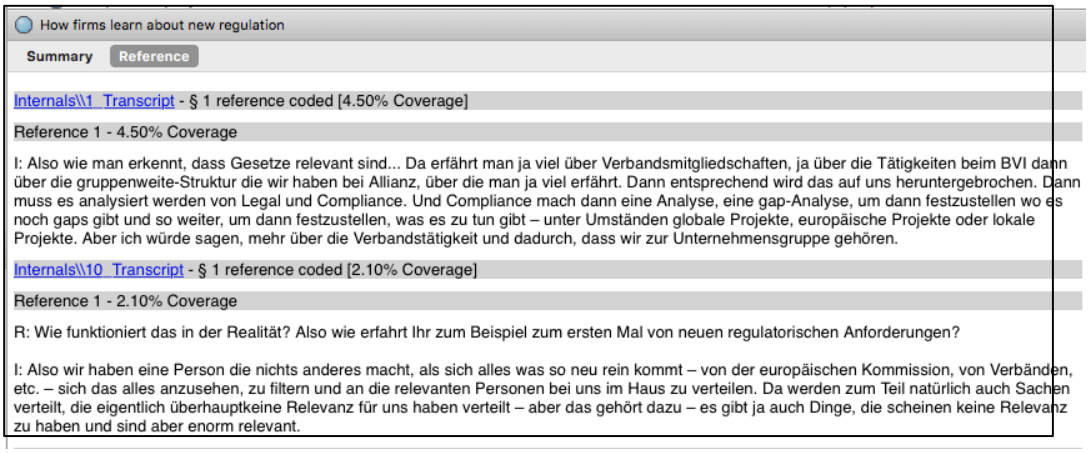


**Fig. 13***: Screenshot from NVivo Illustrating How the Software Was Used to Mark Different Text Passages Relating to the Same Incident.*

Secondly, the NVivo software was used to support the development of relationships between different codes in order to develop categories and sub-categories (see figure below).


**Fig. 14***: Screenshot from NVivo Illustrating How the Software Was Used to Relate Different Codes into Categories and Sub-Categories.*

Coding incident-to-incident was a constant process throughout phase 1. Whenever one interview was completed it was first transcribed and then the complete text was coded for incidents. The emerging incidents were constantly compared with incidents that had already been discovered in previous interviews. At the same time, all incidents were investigated for potential relationships and were then clustered into groups in order to develop categories and sub-categories.

All of these incidents had emerged as "codes" directly out of the transcripts. For example, informant 3 explained:

*"Compliance is about bringing that law into life – how do you bring a particular requirement into life? – and that is not explained in the law – so just take the example of best execution – where the requirement is to achieve the best possible result given a set of potential outcomes – how does that work? – you can say there are probably 10 different parameters, but they are all not the main one at any point in time – collectively they can be – but even just one or two can also be the determinant over that particular transaction – so compliance has the job of finding a solution – how do you translate that one requirement into processes? How many steps do you need to take to be able to demonstrate and document that what you do – and then once you do that – how do you bring all of that into a process? Into what*

*people do on a daily basis? That´s what I mean by embedding into the daily processes –"*

This incident was coded under the label "Embedding law into internal policies". In this specific example the informant provided the label for the incident directly in the text. This specific code is therefore what is termed "*in vivo code"* in grounded theory terminology (Charmaz (2006), 55). Other codes were labelled with abstract titles that were not mentioned by the informants directly (e.g. "Examples of normative compliance").

The table below lists all 22 incidents, which were identified by an analysis of the three initial interviews.

| **Incidents ("Codes")** | **Inf. 1** | **Inf. 2** | **Inf. 3** |
|---|---|---|---|
| Law is transformed to internal policies | 1 | 1 | |
| Expectation that internal rules are respected beyond the law | 1 | | |
| New regulation changes corporate culture | 1 | | |
| Guidance by industry associations is important for compliance behaviour | | | 1 |
| Industry lobbying | | | 1 |
| Regulators set new standards | | | 1 |
| Embedding law into internal policies | 1 | | 1 |
| Compliance Officer is personally liable | | 1 | |
| Describes the role of the Compliance Officer | 1 | 1 | 1 |
| "Three lines of defence" | | 1 | 1 |
| Conflicts between Compliance and Management | 1 | | 1 |
| Fear of losing assets and clients | | 1 | 1 |
| Fear of negative reputation (various) | 1 | 1 | 1 |
| How external auditors influence compliance behaviour | | 1 | 1 |
| How industry associations influence compliance behaviour | | | 1 |
| How senior management influence compliance behaviour | | 1 | |
| How the Legal department influences compliance behaviour | | | 1 |
| How the Risk Management department influences Compliance behaviour | | | 1 |
| Examples of deterrence | 1 | | |
| Examples of normative Compliance | 1 | | |
| How "group pressure" influences compliance behaviour | | | 1 |
| Historical development of the Compliance profession | | 1 | |

**Table 3***: Incidents ("codes") Identified by Analysis of the Initial 3 Interviews During Phase 1.*

In a next analytical step, the codes that were discovered in the interview data were sorted and more abstract categories were inducted. Reflective thinking and, especially, memo writing were used in order to develop these abstract categories. This process benefitted from the fact that the researcher is also an experienced compliance professional. It was therefore possible to reflect on the findings also against his personal professional experience.

The table below illustrates which different codes were combined into thematic categories.

| **Thematic categories** | **Incidents ("Codes")** |
|---|---|
| Compliance Changes Corporate Culture | Law is transformed to internal policies |
| | Expectation that internal rules are respected beyond the law |
| What Changes Compliance Culture in a Firm | New regulation changes corporate culture |
| What Changes Compliance Culture in an Industry | Industry lobbying |
| | Regulators set new standards |
| What is Compliance Culture | Embedding law into internal policies |
| Features of a Compliance System | Compliance Officer is personally liable |
| | Describes the role of the Compliance Officer |
| | "Three lines of defence" |
| How Firms Learn about New Regulation | Guidance by industry associations is important for compliance behaviour |
| Interaction with Stakeholders | Conflicts between Compliance and Management |
| Motivations for Compliance Behaviour | Fear of losing assets and clients |
| | Fear of negative reputation (various) |
| Roles of Different Stakeholders | How external auditors influence compliance behaviour |
| | How industry associations influence compliance behaviour |
| | How senior management influence compliance behaviour |
| | How the Legal department influences compliance behaviour |
| | How the Risk Management department influences Compliance behaviour |
| Economic Compliance Motivation | Examples of deterrence |
| Normative Compliance | Examples of normative Compliance |
| Social Compliance | How "group pressure" influences compliance behaviour |
| Historical Development of the Compliance Profession | Historical development of the Compliance profession |

**Table 4***: Development of Thematic Categories out of Incidents During Phase 1.*

In summary, the following thematic categories had emerged from the codes identified in the interview data during phase 1:

- Compliance Changes Corporate Culture
- What Changes Compliance Culture in a Firm
- What Changes Compliance Culture in an Industry
- What is Compliance Culture
- Features of a Compliance System

- How Firms Learn about New Regulation
- Interaction with Stakeholders
- Motivations for Compliance Behaviour
- Roles of Different Stakeholders
- Economic Compliance Motivation
- Normative Compliance Motivation
- Social Compliance Motivation
- Historical Development of the Compliance Profession

At this point in time it was not yet clear whether the thematic categories would ultimately be relevant for the development of substantive theory. In particular, it was unclear how these categories might be related to each other. For example, the category “Features of a Compliance System” might potentially be related to the categories “How Firms Learn about Regulation”, “Interaction with Stakeholders” and “Motivations for Compliance Behaviour”. But this clarity was also not planned (or expected) to achieve during phase 1, which was planned as a pilot phase.

### Summary of Phase 1

Phase 1 was planned as a pilot phase. It should help to get some initial experience with GTM research and to test whether the interview guide would work in practice. One goal of phase 1 was to develop and to test an interview guide. This goal was achieved, and the interview guide allowed a focussed discussion with the informants during the interviews and helped to steer the discussion around all topics of relevance for the present study. At the same time, the use of the interview guide did allow enough flexibility, not to prevent the start of an open discourse between the researcher and the informants during the interview.

All three interviews had been coded incident-by-incident and 22 different incidents/codes had been identified in the data. In a second analytical step these codes had also been abstracted into some thematic categories. These codes and thematic categories were considered a good foundation for further development during the course of the following phase 2 of the empirical work.

Another aim of phase 1 was to identify and connect to further interview participants. This aim was achieved, too. Most of the interview participants of phase 2 were only accessible to the researcher, because interview participants of phase 1 helped to connect the researcher with these additional participants.

## Phase 2 – Interview Phase

As phase 1 was successful, phase 2 was continued in the same manner and could also be described as an "extension" of phase 1. The main difference between phase 1 and phase 2 was that phase 2 aimed to collect sufficient interview data in order to develop meaningful and "rich" codes, which could ultimately be used to induct substantive theory.

As in phase 1, data collection and analysis took place in altering sequences during phase 2. The existing codes and thematic categories that had already been identified out of the three interviews performed during phase 1 were used as basis for further development during phase 2. Ten additional in-depth interviews with relevant members of the compliance elite and some other experts were performed, transcribed and analysed. The following section will provide a detailed overview of the findings made during phase 2.

### About the Interviews and the Participants in Phase 2

The interview guide developed and tested during phase 1 was used during phase 2. All interviews lasted around one hour and were recorded and transcribed for analysis.

The strategy of performing interviews with the elite of the compliance experts had proven to deliver relevant data during the pilot phase and was therefore continued during phase 2.

Altogether, 10 additional interviews were performed with members of an elite of experienced compliance professionals and other similar participants: Seven of these interviews were performed with experienced professionals working as department leaders for asset management companies. All had similar working experience as the experts interviewed during phase 1. Four of these participants were male and three were female. Five were from Germany and two from the UK.

Theoretical sampling was used in order to identify three industry experts from other relevant areas. Theoretical sampling is a tool used specifically by grounded theory researchers. Strauss and Corbin (2015), 134 define theoretical sampling as follows:

"*A method of data collection based on concepts derived from data. The purpose of theoretical sampling is to collect data from places, people, and events that will maximize opportunities to develop concepts in terms of their properties and dimensions, uncover variations, and identify relationships between concepts.*"

The idea of theoretical sampling is to enhance the efficiency of data collection by linking concepts derived from data back to data collection.
Data obtained during phase 1 had indicated that external consultants and the firm´s internal legal department both play an important role in the identification of relevant regulation and for the development of internal policies and processes to ensure good compliance behaviour. Consequently, it was decided to perform an interview with an experienced consultant at manager-level, working on various regulatory projects in the asset management industry and with an experienced head of a legal department within an asset management firm. Further to this, some data had indicated that the firm´s internal risk management department could play an important role in the development of internal processes aimed to comply with regulatory obligations. Therefore, it was decided to perform an interview with a very experienced head of a risk management department within an asset management firm.
These three interviews were a very efficient way to get a good understanding of the aspects specific to each of these three areas. Additionally, these interviews allowed testing of whether there are any important leads that would suggest extending the study further away from the focus on compliance professionals.
Adding the five interview participants from phase 1, by the end of phase 2 the database consisted of 10 interviews with experienced compliance professionals and three interviews with participants from other relevant areas, resulting in a sum of 13 interviews altogether (see table 5 below).

| | Compliance experts | Other experts | Total number |
|---|---|---|---|
| Total | 10 | 3 | 13 |
| Germany | 7 | 3 | 10 |
| UK | 3 | 0 | 3 |
| Female | 5 | 0 | 5 |
| Male | 5 | 3 | 8 |

**Table 5***: Overview of All Interview Participants (Phase 1 and Phase 2 Combined).*

### Data Analysis and Development of Categories in Phase 2

Data collection and analysis continued to take place in alternating sequences. All interviews were recorded, transcribed and the transcripts were coded incident-by-incident in the same manner as described above for phase 1.

Coding the ten additional interviews provided 31 incidents/codes in addition to the 22 incidents/codes that had already been identified during phase 1. As already described for phase 1, all codes were developed into more abstract thematic categories. The development of thematic categories out of these codes did provide 4 additional thematic categories. An overview of the complete 63 codes/incidents and the corresponding thematic categories that were identified by the end of phase 2 is provided in the appendix (Appendix 3 – Codes and Categories Developed After Phase 1 and Phase 2).

Even more important than the development of new thematic categories, was the discovery of a variety of new incidents/codes, which could be linked to the existing thematic categories. This helped greatly to enrich the quality of the pre-existing data and to understand better how the different thematic categories actually relate to one other.

### Summary of Phase 2

Phase 2 continued to yield a large amount of text from the 10 additional in-depth interviews that were performed. The analysis of the interview data continued in the same manner as in phase 1. It became evident that all relevant incidents/codes had now been exhausted. Especially towards the end of the interview series reports by the informants became largely repetitive. It was therefore concluded that theoretical saturation had been achieved by the end of phase 2 and any further interviews would not yield any significant new insights into the social phenomena of interest for the present study.

The new incidents/codes identified in phase 2 were all reviewed for their relation to each other and to the social phenomenon investigated in the present study (how regulations change corporate culture/ compliance behaviour of firms). This analytical step could therefore be described in grounded theory terminology as "axial coding". It was thereby possible to link incidents that had emerged directly out of the interviews to abstract sub-categories and relate them to broader concepts.

The table below illustrates how the various categories were linked to broader theoretical concepts. By the end of phase 2 the two concepts "Motivation for Compliance" and "Compliance Behaviour" started to emerge as the main themes. Furthermore, certain other thematic categories that surfaced during the analysis of the interview data could not be clearly linked to any specific broader theme (see table below).

How these broader themes have been linked in detail and how the broader concepts have been used to construct new theory will be laid out in the next chapter "Presentation of Findings".

| **Broader Theme** | **Thematic Categories** |
|---|---|
| 1. Motivations for Compliance | Economic Compliance Motivation |
| | Normative Compliance Motivation |
| | Social Compliance Motivation |
| 2. Compliance Behaviour | Compliance Organisations |
| | Compliance Projects |
| | Features of a Compliance System |
| | How Firms Learn About New Regulation |
| | Implementing International Regulation |
| | Interaction with Stakeholders |
| | Motivations for Compliance Behaviour |
| | Roles of Different Stakeholders |
| Other topics | Future of Compliance |
| | Compliance Changes Corporate Culture |
| | What Changes Compliance Culture in a Firm |
| | What Changes Compliance Culture in an Industry |
| | What is Compliance Culture |
| | Historical Development of the Compliance Profession |

**Table 6***: Development of Broader Themes out of Thematic Categories in Phase 2.*

## Phase 3 – Re-evaluation

The results of phase 1 and phase 2 were presented at the EMAB conference 2016 in Warsaw and were also discussed with the researcher´s supervisors. The feedback received suggested that something was still missing and that the categories that had been constructed should be developed further. The emerging concepts were nicely grounded in the data and based on a variety of multiple incidents, but it appeared that the concepts could be further improved, if additional information relating to the corporate culture and history could be used to better support it.

Feedback included the suggestion that some of the categories that were labelled "other topics" could potentially be relevant for the two emerging concepts. Furthermore, it seemed that these concepts could be further structured in order to develop a clear theory.

As proposed by Charmaz (2006), 17, "false starts" are hardly exceptional for the beginning of a research project, it is just that the researcher hardly reports on this. While phase 1 and 2 were not a complete false start (particularly, since the interviews were very successful and have provided sufficient data to build a grounded theory), it still became clear that another phase of re-evaluation would greatly benefit the outcome of the present study.

Therefore, it was concluded that no additional interviews would be needed at this stage, but that the data should be re-evaluated in order to further improve the concepts. This phase of re-evaluation can be considered a third phase of data analysis and the details of this analysis as well as the findings will be provided in the following section.

## Data Analysis During Phase 3

Phase 3 was not intended to be viewed in isolation from the first two phases. The data used during phase 1 and 2 and also the concepts and categories explored during these phases should be used as the starting point for phase 3. Therefore, phase 3 did not involve any further interviews.

However, as the coding of incidents was used to analyse the data during phase 1 and 2 it was decided that re-coding the interview data with a different coding methodology could help to develop a fresh view on the data and the categories. Also Charmaz (2006) suggested that line-by-line coding can be an enormously useful tool for the researcher, as it can help to recover ideas that had escaped the

researcher´s attention when coding for incidents. In order to do so it was decided that all transcripts made from the recorded interviews were printed and line-by-line coding was performed with pen and paper in order to develop a new perspective on the data. This was a very laborious and time-intensive process. The results of this line-by-line coding exercise were, however, fruitful and did provide new perspectives and new insights into the data. Much like phase 1 and 2, memo writing supported this process.

One learning from the line-by-line coding was that the informants actually did disclose deep insights into their personal internal thinking. This important aspect was largely overlooked during phase 1 and 2 and was very useful in order to better understand how different categories were interlinked.

Focussed coding for codes relating to the internal thinking of the informants followed the line-by-line coding. Focussed coding was conducted with pen and paper, but codes were later recorded in an Excel table.

Lastly, axial coding was used differently in phase 3. The aim of axial coding during this phase was to establish connections between the informants´ internal thinking, action and perceived outcome, in order to construct further links between the various categories.

### Summary of Phase 3

Phase 3 was different to the previous phases, as it did not involve any additional interviews. Nevertheless, phase 3 was very time-consuming, as it involved a complete re-evaluation of all data.

As will be illustrated in the following chapter, line-by-line coding inspired new insights into the data and led to the discovery of additional links between categories. Furthermore, the use of an action/consequence matrix (also illustrated in the following chapter) helped a better understanding of the informant's internal thinking. Finally, phase 3 allowed a clear understanding of the interview data yielded in phase 1 and 2 and enabled the development of new theory.

## Chapter Summary

The data for this study were collected in the form of in-depth interviews with members of an elite of compliance professionals in the asset management industry. As explained in the chapter "Methodology," data collection and analysis took place in alternating sequences. This was a major element of the grounded theory methodology.

To begin with, three in-depth interviews were conducted and transcribed (Phase 1). These three initial interviews served as a pilot study in order to test and refine the questions that were asked and to gain experience in conducting interviews with experts in the field of compliance within asset management firms. Additionally, the results of these interviews were important for the development of some initial grounded theory categories.

The second phase consisted of 10 additional in-depth interviews, which were conducted, transcribed and coded. Large numbers of codes were developed during the analysis of each interview by open coding with the support of NVivo software. By the end of this phase some core categories had emerged, and a paper was developed to present these categories at the EMAB conference in Warsaw. The feedback received during the presentation of the paper at the conference and consecutive discussions with the researcher´s supervisors showed that the initial categories were not yet mature enough. It became clear that the data analysis needed to be refined further. Based on this feedback it was decided to re-evaluate all interview transcripts, which led to the next phase.

Phase 3 consisted of diligent re-evaluation of all data and the grounded theory categories that had been developed during phase 2. The table below provides a summary of the different phases used for the present study.

The findings and results of this long-lasting empirical work will be presented in the following chapter.

| **Time period** | **Data collection** | **Data analysis** |
|---|---|---|
| February 2016 – March 2016 | Phase 1: Pilot phase<br>• Conduct and transcribe 3 interviews (pilot study) | Open coding for incidents with NVivo software + memo writing |
| April 2016 – August 2016 | Phase 2: Interview phase<br>• Conduct and transcribe 10 interviews | Open coding for incidents with NVivo software and axial coding + memo writing |
| September 2016 | Development of final categories | |
| October 2016 – April 2017 | Phase 3: Re-evaluation<br>• Re-coding of all interviews | Open coding "line-by-line" with pen and paper of all transcripts, focused coding with NVivo software and axial coding + memo writing |
| May 2017 – September 2018 | Re-development of final categories and writing of the final study | |

**Table 7***: Data Collection and Analysis Phases.*

# Chapter VI - Presentation of Findings

*At last have made wonderful discovery in Valley a magnificent tomb with seals intact recovered same for your arrival congratulations.* (Carter, 1922)

The above is a quote from the text message that the great explorer Howard Carter telegraphed to his friend and financier Lord Carnarvon immediately after his discovery of the intact tomb of king Tutankhamun. It echoes the feeling of great excitement that Carter must have felt in the moment when his long-lasting search in the Egyptian desert at last led him to his famous discovery.

Clearly, the archeological search for a lost Egyptian tomb is an endeavour that cannot be completed out of a university's library or in a laboratory. Only going out into the field, making excavations and finding artefacts, can make the discovery. Going out into "the world" and discovering what is out there lies at the heart of all empirical research. Many challenges faced by an archeologist are therefore all too familiar to the social scientist engaged in empirical work.

In the social sciences empirical research means going out into the field, meeting with experts and performing interviews in order to understand the "social world". Much like the archeologist searching for a lost tomb, the empirical work of the social scientist is often not a straight path. Howard Carter must have made hundreds of unsuccessful excavations in the Valley of the Kings before finally making his great find. Similar to Carter´s journey, the empirical work conducted as part of the present study was not a straight path but involved a few turns and walking in circles.

The following chapter provides a detailed overview of the findings from the empirical data collection. Tables, quotes of informants, quotes of memos and diagrams will be presented in this section in order to provide an insight into how the final grounded theory categories were gradually developed.

Following an inductive approach ("bottom-up development of knowledge") this chapter will outline in detail how the various findings made in the interview data were linked to thematic categories and ultimately sets the foundation for two separate theoretical concepts: One concept aims to explain how compliance behaviour looks within firms and another concept aims to explain what actually motivates compliance behaviours within these firms. The first concept thereby helps to answer questions such as "How does compliance behaviour look in actual asset management firms?" or "How does compliance work in a firm?", while the second concept is intended to

answer questions such as “Why do asset management firms comply with regulations?” and “What motivates compliance behaviour?”.
As the findings in these two areas are quite different, the following chapter is divided into two separate parts. The first part provides the findings made in relation to compliance behaviour and the second part provides the findings in relation to compliance motivations.

## Part 1. Compliance Behaviour

One aim of the present study was to "open the black box" of compliance behaviour within asset management companies. An important topic for discussion during the interviews was therefore how firms actually ensure proper compliance behaviour within their organisation. This led to the emergence of multiple thematic categories in relation to this topic (see figure below).

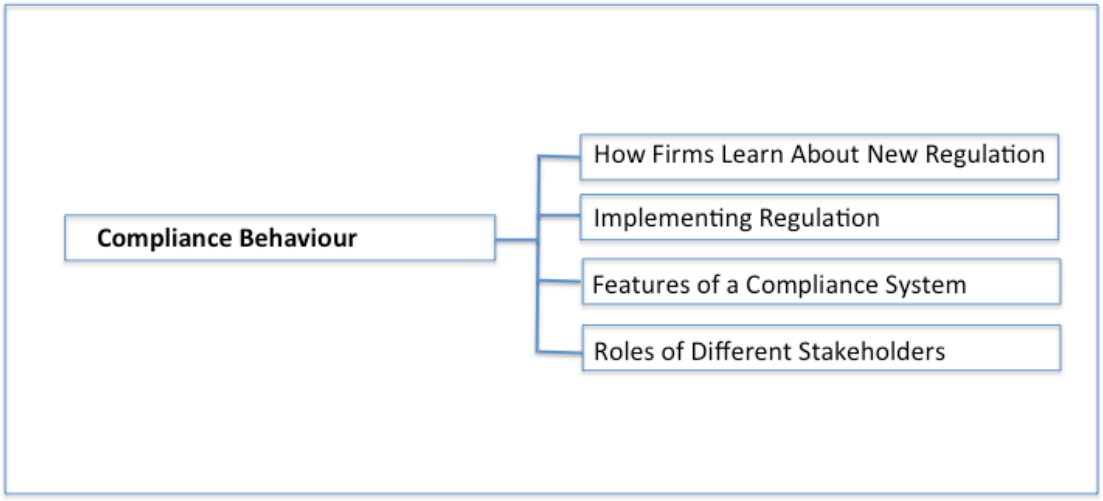


**Fig. 15***: Thematic Categories Linked to "Compliance Behaviour".*

There were four clusters of thematic categories, which could be linked to compliance behaviour:

1. "How Firms Learn About Regulation" is important, as it explains which mechanisms are used by firms to ensure they are aware of all relevant regulatory requirements for their business. Knowing the relevant laws is of course the first step in order to be compliant.
2. "Implementing Regulation" is important, as it answers the question how firms ensure that their internal processes reflect regulatory requirements after they have identified a relevant requirement.
3. "Features of a Compliance System" relates to the question, how firms overcome the challenge that laws applicable in the context of the firm have to be adhered to by each individual employee.
4. "Roles of Different Stakeholders" is important, as it illustrates that different stakeholders within a firm fulfil different roles in order to ensure that the firm as an organisation learns about new regulations, implements relevant requirements and ensures that all employees adhere constantly to these rules.

The first three thematic categories relate to different behaviour patterns that a firm has to go through in a consecutive order, whenever a new regulation is implemented (see picture).

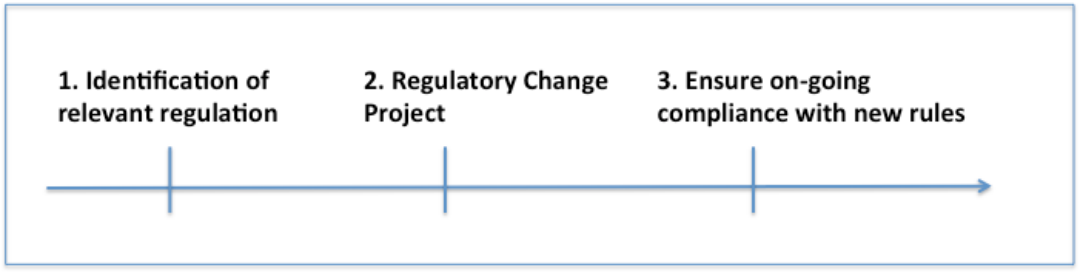


**Fig. 16***: Typical Behaviour Pattern of Asset Management Firms in Order to Ensure Compliance Over Time in a Consecutive Order.*

The last thematic category relates to the specific roles of the key stakeholders to these processes. The following section will outline the features identified for each of these thematic categories during the interviews in more detail:

### 1. How Firms Learn About New Regulation

Asset management companies operate their business in a highly regulated environment. It is therefore not easy for these firms to know all relevant laws and regulations at any time. The fact that the relevant laws and regulations are not static but are subject to continuous development (e.g. the European UCITS Directive 85/611/EEC began as UCITS I in 1985 and was further developed four times by 2014 into the UCITS V Directive 2014/91/EU) makes it challenging to know all relevant rules at all times.

Furthermore, asset management companies are also changing their business operations and developing new products. New business areas or new products may require compliance with different sets of regulations that have not been relevant to the firm before.

Therefore, the first relevant step for an asset management company to be compliant with all relevant laws and regulations is to know all relevant regulations. The thematic category “How Firms Learn About New Regulation” summarises the findings in this segment of compliance behaviour.

Interviews indicated that most firms regard their internal compliance or legal department as responsible for identifying all relevant laws and regulations at any time.
Multiple informants mentioned that for them a membership in an **industry association** is key to learn about new regulations and their implications. For example, informant 5 explained:

"*One important source of information is of course our industry associations like the German BVI. These industry associations will provide regular newsletters and offer working groups to their members in order to inform them about the latest regulatory developments*."

Industry associations are important in the process for two reasons: Firstly, because they can often act as a single point of contact to the regulator and thereby work as an important "facilitator" between the industry and the regulator. Informant 3 elaborated:

*"[…] The whole idea is that the industry has views and the industry associations role is to represent those views towards the regulator or law makers. They will make sure that their members´ voices are heard by the regulator. On the other hand the regulator does not have to deal with 5.000 independent voices, but gets information from one industry organisation. They can ensure that only topics that are relevant for the majority of the firms in the industry are raised. So, if something is a problem for 10 firms, it is not a real problem – but if something is a problem for 4.900 firms it is a big problem. Hence, the regulators immediately get this sense of proportion*."

Secondly, because they provide a platform for representatives from different companies to meet, exchange ideas and discuss concerns.
Industry associations establish working groups, which allow representatives of different firms to meet in a neutral environment and exchange ideas. For example, informant 7 explained:

"*Working groups play an important role. They allow meetings with Compliance Officers from different companies and have informal exchange of information. There you can openly ask how other companies deal with a certain new regulatory challenge*."

Memberships in industry associations are therefore an important way for asset management companies to inform themselves about new developments and to exchange thoughts with their peers.

Another important source of information about new regulations described by the informants were company **internal regulatory advisory departments**. Apparently only the larger companies can afford to operate internal regulatory advisory departments in addition to their legal and compliance departments. These departments are not understood as a subsidiary for a membership in an industry association, but rather as an addition.
Lastly, an important source of information was seen through the use of **external Consultants and law firms**. This was regarded as particularly important by firms operating multinational business models, which require them to monitor regulatory changes simultaneously in multiple jurisdictions. Local industry associations can provide useful updates about the home jurisdiction, but not about multiple other jurisdictions. Informant 11 provided a good example:

*"[…] so we monitor various data basis – but also we work closely together with local law firms. For example, we are also registered in South Korea and if there was anything going on in South Korea our local law firm there would act as our agent and inform us about it."*

Another aspect that emerged from discussions with various informants is that asset management companies see regulation not necessarily as a "one-way street". Moreover, they regard for example their membership in industry associations as an effective way to influence the regulator to change certain new regulations, before they actually come into force by "**lobbying**". For example, informant 4 explained the following:

*"[…] the first step to comply with a regulation is to know the regulation. Perhaps better still is to monitor the formation phase of new regulation and get actively involved in the shaping process of a new regulation. This allows you to prevent things from developing in a way that will later "fall on your feet" – this is the classical "lobbying", which we do via industry associations like BVI and EFAMEA*."

## 2. Implementing Regulation

If a new regulation is identified, the next step in this process is to understand what a new regulation actually means for a specific product or business model within an individual company. While it is easy for an individual person to know the implications of a new regulation (e.g. if the law says "smoking is now prohibited in

public places", then everyone knows what to do), it can become quite complex in the context of large multinational asset management companies and financial markets regulation. For example, with the implementation of the new MiFID II Directive (2004/39/EC) German asset managers are required to delete electronic data collected in relation to the reception or transmission of orders after 5 years. For efficiency reasons multinational asset managers will typically utilise a global data repository to store such data centrally. If other jurisdictions, such as the USA require that this data must be stored at least for a period of 7 years the implications of the new MiFID II requirements are that such a globally centralised data repository can no longer be utilised.

It is therefore equally important for these firms not only to monitor new laws and regulations, but also to understand how certain laws may have implications for existing business processes, systems, policies and processes.

Depending on the complexity of a firm and on the foreseen impact of a new regulation, asset management companies will organise the set-up of regulatory change projects in order to perform a detailed gap-analysis and to implement all relevant measures into their business processes. Again, the compliance department plays a crucial role during these projects. Informant 6 commented:

*"If you look at how many new regulatory requirements had to be implemented after the financial crises in 2010, I get the impression that the compliance department has de facto become a project office*."

Likewise, if an asset management firm ventures into a new business field or develops a new product it will typically organise an internal "New Product Initiative Project". The difference between a regulatory change project and a new business initiative project is that the former aims to understand how new regulations are relevant for the existing business of the firm, while the latter aims to understand how existing regulations are relevant for the new business area or product.

The interviews have shown that regulatory change projects are most often driven and coordinated by the compliance department. However, there are two other stakeholders that play an important role here: The legal department and external Consultants. This was the reason, why an additional interview was performed with the head of a legal department and with a Consultant.

Informant 12 (a Compliance Officer) explained the role of the legal department as follows:

"*The legal department does come into this – but according to my experience only to a very limited extent. We tend to refer to legal whenever we struggle to understand how to implement a certain rule, when it is quite complex and when you also don´t get any consent within your own peers – that is when you would turn to legal for some further input*."

The legal department is hence often understood as a kind of "in-house law firm" that can be asked questions about the interpretation of complex legal issues. Thus, the legal department can play a very important role within the internal "learning process" that each company has to go through in order to understand a new law.
However, in contrast to the compliance department, the legal department does not typically play any active role in the implementation project, nor is the legal department involved in the ongoing monitoring or training activities that might be conducted.
In fact, the role of the legal department appears to be very much limited to the role of an advisor. Informant 7 had the following view:

"*Within a company it is the responsibility of the compliance department to ensure that all relevant laws are detected and that internal processes are adjusted as needed. The legal department supports the compliance department especially with the interpretation of legal texts. More important than the legal department is in my view the support of external Consultants. External Consultants or law firms can also be tasked with drafting policies for the company. Since internal processes are governed by the rules stipulated in these policies, they thereby help to directly ensure that the company complies with the new regulatory requirements*."

Specialised consultants and law firms are also relevant in this process. Informant 8 (a Consultant) explained the roles of external Consultants:

*"According to my personal experience many companies try to manage new regulatory change without the help of external Consultants. Only, if they realise that they cannot manage a certain issue alone will they reach out to us (external Consultants). I believe the added value that external Consultants bring in is that they have a different view. Oftentimes they have advised on similar issues in different companies and can provide benefits from these experiences."*

Consultants can bring additional expertise on certain topics and offer the advantage of a different perspective. Most informants echoed that both, the role of the legal

department, the role of Consultants is mainly the role of an advisor and they are not actively engaged in projects or monitoring activities.

## 3. Features of a Compliance Management System

After a new law had been identified as relevant and the internal business processes are adjusted to the new requirements, firms face another problem: As the below section about compliance motivation will outline in more detail, compliance behaviour exists in companies on a "micro level" (the compliance behaviour of individual employees) and on a "macro level" (the compliance behaviour of the company as an organisation). The problem therefore is to ensure that the individuals on the "micro level" are acting as is expected of them from an organisational i.e. "macro level" perspective. In other words, companies have to ensure that all employees adhere to the company´s internal rules.

An immediate learning in this regard was that all asset management firms operate a "compliance management system" or in order to "bridge the gap" between the compliance behaviour of an individual employee and of the firm as a holistic organisation. The compliance management system functions as a "filter" in order to filter out all relevant regulations and allocate them to the relevant processes and individual employees within the firm. A note in the researcher´s hand-written field notebook from 6 April 2016 encapsulated this nicely:

*"Compliance (the Compliance department) works as a filter for correct behaviour."*

The figure below illustrates which thematic categories were linked to "Features of a Compliance System".

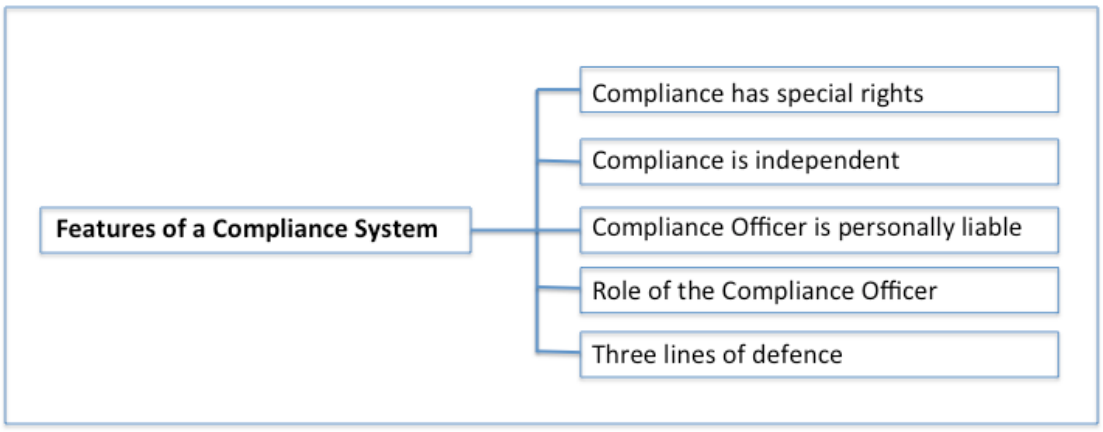


**Fig. 17***: Incidents/Codes Linked to "Features of a Compliance System".*

The informants emphasised the special roles and responsibilities of the compliance department and the Compliance Officer within a compliance management system. It was stressed that the compliance department should be "independent" from other departments and should report directly to the firm´s board of directors. The fact that the compliance department must be independent of other functions in the firm and that the Compliance Officer must report directly to the board of directors is an important factor of the compliance organisation, but as this is legally required for asset management firms in Germany and the UK, this was not a surprise.
More interesting was how the informants described the internal governance processes that their firms would typically use to ensure all employees adhere to the company´s internal rules (i.e. the set-up of the actual "compliance management system"). Most informants described an internal compliance governance process, which they called the "3 lines of defence model" and which was permanently operated.
Although not mentioned by the informants, it seems likely that this model is based on the risk governance framework developed by the Institute of International Auditors, which was presented in 2013 under the same name (IIA, 2013).
Informants explained that under this model the employee who is directly responsible for a specific process is considered "the 1. line of defence". In other words, every employee must assume individual responsibility for proper compliance behaviour in relation to his or her area of responsibility. This means that all employees are responsible for knowing and adhering to all internal and external rules relevant to their job. For example, a stock trader must know the internal rules regarding approved brokers that he is allowed to trade with, and he must have a basic knowledge of relevant legal requirements, such as best execution, which are directly relevant to his job. It is the responsibility of the line managers of each individual employee to ensure that everyone knows and understands the internal and external rules relevant to a specific job within the firm.
An independent department within the firm (namely the compliance department) performs regular controls over all critical business processes. This additional layer in the system is called "the 2. line of defence". The 2. line of defence controls are designed in order to constantly check and watch over the effectiveness of internal

risk-mitigating measures used within the 1. line of defence (e.g. to check if the four-eye principle was applied properly by the front desk to avoid “thick thumb errors”). Finally, the model deploys another layer of independent controls, by using the firm´s internal audit department in order to check, if the controls and advice within the 2. line of defence is performed properly. This is “the 3. line of defence”.

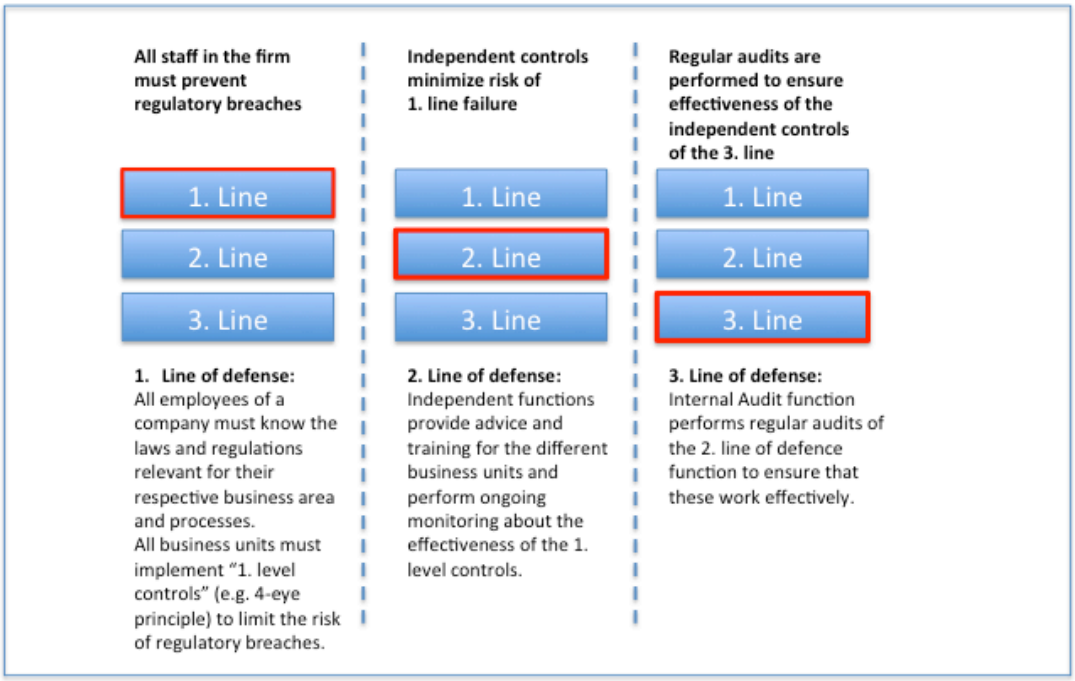


**Fig. 18***: The Three Lines of Defence Model as Explained by Compliance Officers.*

The Compliance Officers interviewed all shared the view that they would be responsible for the 2. line of defence. For example, informant 7 explained the responsibility of the compliance department as follows:

"*Compliance and risk management form together the so called "2. line of defence". That means that the profit-generating business departments (e.g. portfolio management or sales) act as "1. line of defence" and are thus responsible by themselves for ensuring they execute their work in compliance with all relevant rules. Should they fail to do so then such cases will be detected in the "2. line of defence" by compliance. Within the "2. line of defence" compliance works closely together with risk management. I would say that compliance is responsible for monitoring and controlling all regulatory risks and risk management is responsible for controlling operational and portfolio risks."*

This is important to realise, as it reveals deeply how Compliance Officers see their own role and responsibility within the compliance management system.
At first glance one might have thought that the compliance department is responsible for ensuring a compliant behaviour of the organisation at "macro" and "micro" level. However, the Compliance Officers themselves regard it as a responsibility of the employees working in the 1. line of defence to act in compliance with the rules and regulations on a "micro level". Informant 9 provided a good example for this view:

"*Once we had a debate with our internal auditor. He argued that the compliance department should approve each and every research report before it has been made public. I told him that this would be impossible and that the compliance department does not have sufficient resources to do this unless I would hire two additional Compliance Officers. For me the responsibility for the legal correctness of research reports rests with the creator of these reports. I am happy to provide advice and training about the respective legal requirements and perhaps I can perform some sample testing – but ultimately it should be clear that the responsibility for the legal correctness of these reports has to be with the creators of the reports and not with compliance."*

The interviews suggest that the question, who should be responsible in case of a regulatory breach, is subject to an on-going debate between the departments belonging to the 1. line of defence (typical all profit-generating departments line portfolio management, trading and sales) and compliance. Informant 12 described how this self-view has changed over the course of her career:

"*When I started, I even thought it was my responsibility to do all these 1. line tasks such as "Best Execution". If you as a Compliance Officer, informed the business about a new requirement they would ask you "well can you come and do it then?" and they were really unwilling to take ownership by themselves.*
*I think that was because we did not have much training and because there was not yet this articulation of the 3 lines of defence concept. The 3 lines of defence were really propagated by Consultants like EY, KPMG, etc. They introduced this concept as a good business practice and it really helps a lot.*
*That had really helped compliance – but I think until today our big issue really is to have our voice heard at the top level*."

This debate illustrates that the "3 lines of defence model" (and hence the internal governance system) is not free of internal conflicts. These conflicts could lead to situations of disagreement over certain individual's responsibilities. If such conflicts materialise within a firm, they can also impact the firm's compliance behaviour and could lead to situations where individuals are behaving in a way not compliant with the internal rules and thereby potentially cause the firm to violate certain legal requirements on a macro level.
However, it can also be concluded that a compliance management system that assigns roles and responsibilities to each individual employee and which provides for on-going monitoring conducted by an (independent) compliance department is a very efficient way to control the compliance behaviour of larger companies efficiently. In fact, such a system seems necessary in order to "bridge" between rules that have to

be applied on a “macro level” to the company as an organisation and the rules that have to be adhered to by individual employees within the firm on a “micro level”.

## 4. Roles of Different Stakeholders

It becomes clear from the interviews that various individual stakeholders up to the individual employees who take responsibility for their respective jobs are relevant in the context of the compliance behaviour of an asset management company. However, there are certain key stakeholders within the companies, which are especially relevant to the firm´s compliance behaviour. While the roles of these key stakeholders were already implicitly described in the above sections, the following section aims to provide a clear picture of each of these stakeholders and their respective influence on the firm´s compliance behaviour.

### *The Compliance Officer*

The Compliance Officer is the key person within the firm who is responsible for organising the "compliance function" (i.e. the compliance department). The compliance function ensures that the company knows and adheres to all relevant regulations. As informant 12 explained:

"*Within a compliance function – you would have a team of people – you would normally refer to them as "regulatory development team" – and that´s a team within the compliance function. Their task would be to identify changes in regulations and new regulation coming through*."

Furthermore, after a new regulation was identified as relevant in the context of the firm´s business activities, the compliance function is often responsible for organising a regulatory change project. Informant 7 explained:

*"I regard the implementation of legal requirements within internal processes as a very important task for the compliance department. This is a key task!"*

As quoted in the section above, one informant even mentioned that ironically managing projects had become so important for the compliance department that he begins to wonder, if he is actually more a Project Manager than a Compliance Officer. Without a doubt it can be concluded that managing regulatory change projects is another important task of the Compliance Officer.
Lastly, as outlined in the section above, the Compliance Officer is also responsible for ensuring the on-going compliance of the company after the completion of a regulatory change project. Implementing and operating a good compliance

management system will usually achieve this goal. As the interviews have shown, all Compliance Officers participating in the study operate a compliance management system that is based on the "3 lines of defence model". All Compliance Officers regard themselves as part of the "2nd line of defence".
It can be summarised that the Compliance Officer (as the head of the compliance function) has a significant influence on the firm´s compliance behaviour for an asset management company. The Compliance Officer is the first to identify any new legal requirements, he is responsible for organising a regulatory change project and he must ensure adherence to the new rules within the company on an on-going basis.

### *The Board of Directors*

Another relevant internal stakeholder is the company´s senior management or board of directors. Several Compliance Officers explained that they regard themselves as agents of the firm´s board of directors. For example, informant 5 stated:

"*The responsibility of ensuring that all relevant laws are adhered to within the firm lies with the compliance department. However, the compliance department is only "the extended arm" of the board of directors. The ultimate responsibility rests with the board."*

This view is not surprising, as by law the board of directors of German or UK-based asset management firms is legally responsible for ensuring that all parts of the company comply with all relevant laws. From this point of view, it is therefore correct to say that the board of directors is ultimately responsible for compliance within a firm.
However, in reality the boards of all major asset management firms have hired Compliance Officers in order to organise a compliance function, which deals with all compliance-related issues on a daily basis. In reality the influence of the board of directors on the firm´s compliance behaviour is therefore limited. Informant 3 confirmed that the role of the board is actually limited, when he stated:

"*So, it is an expectation by the management that somebody else is responsible*"

In fact, the interviews conducted in the present study suggest that the only areas where the board can (at least indirectly) influence the firm´s compliance behaviour

are (1.) by providing all required resources to the compliance department and (2.) by supporting their Compliance Officer internally ("tone from the top"). Although, these are both important factor for fostering a good compliance culture within the firm, it must nonetheless be concluded that the board will ultimately not be involved in compliance-relevant processes to the same level as the compliance function (i.e. the board will not usually be involved in identifying new laws or providing training for staff). The role of the board of directors is rather somewhere in the background.

### *The Legal Counsel*

Another relevant internal stakeholder was identified as the internal Legal Counsel. Most asset management companies have an internal legal department with one or multiple internal Legal Counsels. The Legal Counsel is understood as an internal expert and supports the compliance department with the interpretation of unclear or new regulations. Informant 5 viewed the role of the Legal Counsel as follows:

"*The legal department provides their advice. It is, for example, responsible for helping with the interpretation of legal requirements or for drafting contracts*."

The internal Legal Counsel only indirectly influences the actual compliance behaviour of a firm. However, the role of the internal Legal Counsel is not insignificant. Many informants echoed in their interviews that they believe that only the Legal Counsel has the ultimate authority for the interpretation of any unclear regulation within the firm. Informant 9 explained that this could be a decisive factor for actual compliance behaviour within a firm:

"*[…] Of course, this can often lead to a situation of "opinion shopping". For example, staff that received a clear "no" as the answer from the Compliance Officer may walk to the Legal Counsel with the hope that he changes this "no" into a "yes". If this works, the staff will return to the Compliance Officer and confront him with this situation. This seems to be the case in all firms. In our firm, we try to manage this problem by locating the legal and compliance departments on the same floor and ensure close alignment between both*."

The Legal Counsel has some internal authority with regards to the interpretation of regulation and works closely together with the compliance department. Although, the Legal Counsel does not have the same level of day-to-day involvement in the firm´s actual compliance behaviour, he is still an important stakeholder.

### *The Risk Manager*

The internal risk management department was identified as another important factor for the firm´s compliance behaviour. Informant 3 has outlined the role of the risk management department as follows:

"*Compliance and risk are two complimentary functions – where risk comes in is – risk has a kind of a mandate managing the companies risk appetite – this is never quite defined in a way that is by regulation – but regulation has tried to define different types of risks*."

Within an asset management firm risk management is thus responsible for advising the board of directors on business-related risks. The risk of breaching regulatory requirements is also managed in this way. Informant 8 explained:

"*[…] the complete compliance organisation is actually just a way to mitigate regulatory risk*."

This is important to understand, as the board of directors will consider advice by risk management, when it has to decide how much resource a firm should invest into the compliance organisation or if a certain new business activity should be pursued or not.

### *The External Consultant*

It became clear that a series of external stakeholders are at least indirectly relevant for the compliance behaviour of asset management firms. Firstly, it was mentioned by multiple informants that they would often rely on **external Consultants** (external Business Consultants and external law firms) to support regulatory change projects. For example, informant 4 made the following observation:

*"[…] so regulation became very complex, which consequently increased the demand for external expert´s opinions. The only other alternative would have been to hire more experts internally, which would have made little economic sense*."

It is interesting to note that according to the view of informant 4 it would make little economic sense for asset managers to hire more experts within the firm. Expert advice is seen as a purchasable service rather then something that needs to be built

up within the organisation. External Consultants are thankful for such a perception, as it is their guarantee for a good business relationship with asset management firms. In fact, the less internal legal experts an asset management firm has, the more it will depend on its external Consultants.
The relevance of external Consultants for the compliance behaviour of an asset management firm is consequently similar to the role of the internal legal department. Both are seen as advisors and can thereby at least indirectly influence the compliance behaviour of these firms.

### *The Industry Associations*

Another important external stakeholder was identified with the industry associations (the BVI in Germany and the IA in the UK). Industry associations provide a platform for exchanges of views between all firms within the industry. Often this exchange of thoughts is related to new regulation. The industry associations are well connected with the regulators and will make sure they voice members concerns in order to influence the development of new regulations, where possible. Informant 3 has summarised his view about the role of the industry associations as follows:

*"The whole idea is that the industry has views and the industry association´s role is to represent those views towards the regulator or law makers. They will make sure that their members voices are heard by the regulator.*
*On the other hand, the regulator benefits as well, as he does not have to deal with 5.000 independent voices."*

It can be summarised that industry associations play an important role in the compliance behaviour of asset management firms. Industry associations provide a platform for discussion to the industry on the one hand and a "single point of contact" for the regulators on the other hand. In doing so industry associations are indirectly relevant to the compliance behaviour of individual asset management firms.

### *The Regulator*

Another stakeholder with relevance for the compliance behaviour of asset management firms is the regulator (the BaFin in Germany and the FCA in the UK). Per definition regulators are responsible for monitoring and supervising the regulated

asset management firms. That means that regulators can potentially have a direct influence on a firm´s compliance behaviour (e.g. if it revokes a licence or makes it pay a fine). The interviews suggest, however, that the indirect influence that regulators have could be far more significant. Informant 3 described how regulatory sanctions might be relevant for a firm´s reputation:

"*[…] but there can also be a "reputational sanction" – so your non-compliance is published and the whole world will know that you are doing something wrong – so the ability to keep clients and to win new clients is sometimes affected by your reputation for being non-compliant – which is something we see more and more today – because regulators are becoming gradually more prepared to release this information – for example, whenever they have an official sanction against a firm they will publish it on their website – the press is of course very interested in getting this kind of news from the regulators and publishing it*."

It seems likely that such public sanctions have a significant "signalling effect" on other asset managers. If an asset manager was publicly critiqued and sanctioned by a regulator for not complying with a specific regulation, there is a good chance that many other asset managers in the industry will scrutinise their compliance behaviour related to such an incident. Informant 6 stated clearly:

"*[…] but, if Blackrock is being fined 1 million Euro by BaFin for violating important shareholder related duties, this immediately raises awareness of this topic."*

With this example informant 6 referred to a fine of 3.25 million Euro that BaFin had imposed on Blackrock in March 2015 for violation of important shareholder-related duties.[18] Clearly, this example illustrates how such fines, if made public, help to increase awareness for certain regulatory topics. Beyond their authority to directly influence the compliance behaviour of individual firms by sanctioning violations regulators have a significant indirect influence over asset management companies by making individual sanctions public.

Interestingly, the interviews revealed that there is a significant cultural difference between asset management firms regulated by the FCA in the UK and by BaFin in Germany. Nearly all informants were in agreement that the FCA has a tendency to impose more and higher sanctions than BaFin. Overall, the informants described

[18] The details of this penalty are published on BaFin´s official website (https://www.bafin.de/SharedDocs/Veroeffentlichungen/DE/Meldung/2015/meldung_150320_bussgeld_blackrock.html).

BaFin as competent, but very "mild" and FCA as rather an "aggressive" regulator. Informant 7 had experiences with both regulators and provided the following view:

"*I would say that the FCA will enforce regulatory requirements much more aggressively than BaFin. One important difference is that BaFin does not often conduct on-site audits at a firm but relies very much on the reports that it receives from public accountants. The auditors of the public accountants are therefore very much "the eyes and ears" of BaFin. It is, however, questionable, how much one can really learn (about compliance behaviour) by simply reading an audit report. Quite in contrast to that the FCA regularly sends their own auditors into the firms*."

The perception that the FCA is "more aggressive" than BaFin seems partly caused by the fact that BaFin relies often on public accountants to conduct an audit rather than doing it with their own staff. Informant 7 also provided another reason for the different perception of the regulators in the UK and Germany:

"T*he FCA will often times reason an enforcement action with a failure of controls within the firm´s compliance organisation. The FCA holds the board of directors responsible for such control failures within a firm*."

It appears that (unlike BaFin) the FCA is seen as a regulator that critiques not only a misconduct as such but holds the board of directors responsible for failing to ensure the implementation of adequate controls in their firms.

Whether this is true or not, it is a clear finding that the majority of the informants' view BaFin as a "mild" and the FCA as an "aggressive" regulator. The main reasons for this view seem to be firstly that BaFin relies more often on the help of public accountants rather than conducting audits with their own staff. Secondly, the FCA seemingly tends more than BaFin to hold the board of management personally liable for any misconduct within their firms.

It can be concluded that regulators are important stakeholders with an impact on the compliance behaviour of asset management firms. Their impact can obviously be direct, if they enforce a penalty against a firm. Furthermore, regulators have also a significant indirect influence on the compliance behaviour of asset management firms, as they can make their enforcement actions public and thereby cause a "signalling effect" that will raise awareness for a specific issue.

### *The Auditor*

Another relevant stakeholder can be seen in external auditors such as public Accountants (e.g. from firms such as KPMG). As explained in the above section, the German regulator BaFin, in particular relies on auditors to report any failures. Informant 4 provided the following view about the role of the Auditor:

"*The auditor acts upon the order of the regulator and is obliged to conduct an independent audit. However, I don´t think that his role is really significant (in relation to the compliance behaviour of a firm).*"

Interestingly, the informants view the auditor as the "agent" of the regulator. They are well aware that the auditor will submit the final report to the regulator, where it will be reviewed. However, at the same time they don´t seem to think that auditors are really relevant for the compliance behaviour of a firm. One reason for this perception was provided by informant 2:

"*The auditor is in a difficult situation. On the one hand he wants to earn money, but on the other hand he must provide a certified audit report to the regulator*."

The challenge for the public auditors is that they should act as an "agent" to the regulator, while the company that they are auditing pays them. Clearly, if an Auditor is writing a very critical Audit report and sends it to the Regulator, the firm that was audited will likely not hire him a second time.
It can therefore be said that auditors have an indirect influence on an asset management´s compliance behaviour. In reality, this influence seems to be limited due to the conflict of interest in which they have to discharge their duty.

### *The Clients*

Another external stakeholder that was identified as relevant to the compliance behaviour of asset management firms is the client. Multiple informants mentioned that they would fear losing clients, if they would get bad publicity for non-compliant behaviour. Informant 6 provided an explanation for that fear:

"*There is no other business, where it is so easy for a client to withdraw his investment and transfer it to someone else. That means that a reputational damage of*

*your brand name will likely cause outflows from client money already on the very next day. There will then be nothing that you can do to stop these outflows*."

This shows that asset management firms are in severe competition with each other. It is relatively easy for clients who have invested their money with Asset Manager A to withdraw this money and invest it with Asset Manager B. As a consequence, asset management firms fear that any negative publicity in relation to non-compliance behaviour (e.g. if they would be publicly critiqued and sanctioned by a regulator) could have a significant impact on their ability to retain existing or acquire new clients. Because of this, clients have a significant indirect influence on the compliance behaviour of asset management companies.
The influence that clients actually have goes even further. Most informants stated that clients would regularly perform a due diligence assessment on an Asset Manager before investing any money. In the cause of this due diligence assessment clients would typically also evaluate a firm´s internal compliance management system and often times even ask for an interview with the Compliance Officer. Informant 5 stated the following:

"*It is true that clients ask often times to speak to the Compliance Officer. However, if a client invests his money depends foremost on whether or not he believes in the investment strategy offered to him by an Asset Manager. Compliance probably has more of an indirect influence. I do however believe that there are certain cases, where compliance can be the decisive factor for a client – especially during turbulent market situations*."

It can probably be concluded that while regulators influence the firm´s compliance behaviour by punishing any misconduct, clients influence the firm´s compliance behaviour by incentivising good compliance behaviour.

### *The Competitors*

The last relevant external stakeholder that was identified during the interviews was the competitor. Multiple informants mentioned the relevance of their competitors for the actual compliance behaviour of their own firm in relation to the development of a "best practice". For example, informant 4 stated:

"*Regulators are looking at different firms and if they like a particular way a firm has developed internal controls, they will even make a public statement about this and*

*call such an example "best practice". Once a certain business practice has become a "best practice" it will be the benchmark for all other business practises*."

This seems especially relevant with regards to the implementation of new regulatory requirements. If one firm implements extraordinarily good business practices and or controls, it will likely set the benchmark for its competitors. This is, however, a double-edged sword, as more elaborated business processes and controls are always costly for a firm. It is therefore also not uncommon for larger firms to meet at industry associations or other platforms in order to discuss how elaborated a specific business process should be on the upper end of the scale.
Informant 3, however, provided an example where such discussion between competitors had in his view caused a significant issue:

*"[…] if they say, we will do this just because we are the 10 biggest players in the market and nobody is going to stop us – this is also wrong, because regulation is not about size – if you don´t meet a rule than it doesn´t matter how big you are – so having 9 other friends that are doing this wrong doesn´t make you right, either! – There were some really big mistakes made because of this – I mean the market timing issues in the USA for example – everybody was doing it – At least 10 firms got fined and that shows that they were not doing it right – everybody was wrong!"*

It can be said that all competitors have an indirect influence on the compliance behaviour of their peers. This is the case, as a peer company can develop better business processes or controls in order to set a new benchmark ("best practice") for compliance behaviour in a specific area. Furthermore, there is a strong cost pressure in the industry and thus no firm would like to spend more money than its competitors to operate elaborated business processes, if this was not really required. As a consequence, asset management firms use industry associations and similar platforms as an opportunity to see how far their peers are going and how much they are investing in new business processes. They will also likely lobby their own ideas in order to set a benchmark that is easily achievable for them.

## What Can be Concluded about Compliance Behaviour?

Synthesising and linking thematic categories to logical groups allows us to draw a picture of how compliance behaviour is determined in asset management firms. This picture consists of the following four elements:

1. Learning about new regulation
2. Implementing regulation
3. Compliance management system
   and
4. Roles of different stakeholders

At this stage of the study it started to become clear that the data collected would allow the development of an actual process-oriented theory that explains how compliance behaviour looks within asset management companies.
As previously laid out in the literature review, compliance behaviour within companies must be defined differently on the level of an individual employee ("micro level") and on the overall organisational level ("macro level"). Asset management firms face the challenge of ensuring proper compliance behaviour on all levels, as the organisation is also responsible for the action of its employees. In order to deal with this challenge and to "bridge the gap" between the micro- and the macro-level, asset management firms have developed internal compliance management systems.
The compliance department stands at the centre of these compliance management systems. The role of the compliance department is to act as a "filter" for regulation, which are relevant for the organisation on a "macro level" and break them down into internal policies and process on the level relevant to all individual employees. The compliance department has therefore three main responsibilities:

1. Identify all new regulations and understand their implications on the firm´s business activities and processes.
2. Ensure that the firm´s general business activities and the firm´s internal processes are in compliance with all regulatory requirements and change internal policies and processes, if needed.

3. Build a "bridge" between micro- and macro level within the firm i.e. to ensure that all individual employees know and adhere to all requirements.

The figure below illustrates the complete implementation process, as described by the informants. Multiple stakeholders within and outside the company influence the actual compliance behaviour of a firm throughout the process.

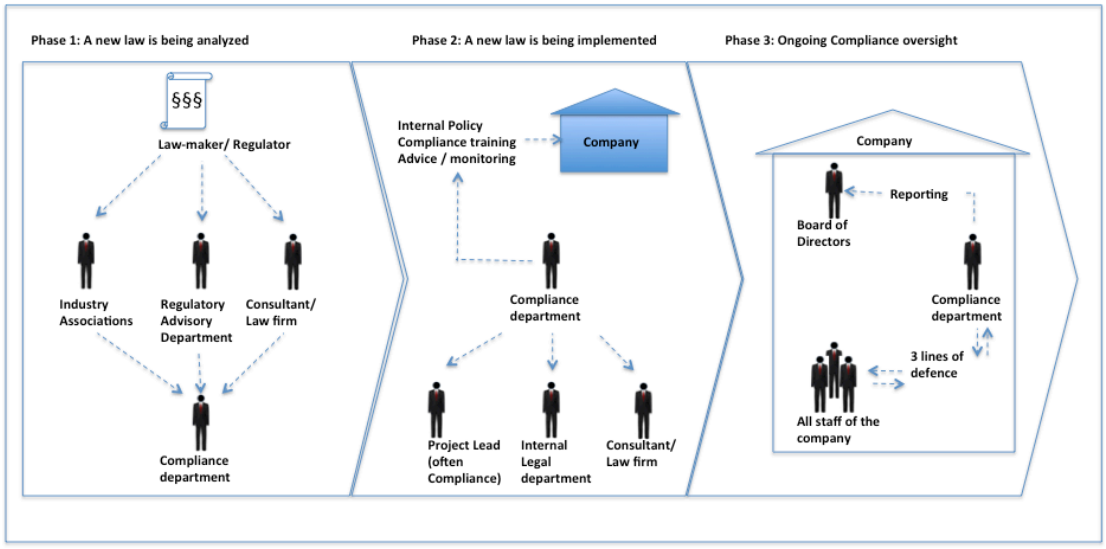


Fig. 19*: The Compliance Process and the Stakeholders Combined.*

As laid out above the research study consisted broadly of 3 phases. Phase 3 was the last phase, which was used to re-evaluate the results from the previous phases. In particular, focussed coding was used during this phase in order to explore what the informants had revealed about their internal thinking in relation to the social phenomena outlined above.

The codes related to internal thinking about compliance behaviour revealed that informants were often thinking about actions and outcomes, which could also lead to conflicts. An Action/Consequence matrix was used as a tool to analyse this relationship.

| Category | Context | Internal thinking | Action, interaction, emotion | Consequence, Outcome |
|---|---|---|---|---|
| Responsibility conflict | Compliance Officer is afraid of being held responsible for any compliance breach in the firm | Informants think that the Compliance Officer should not be held responsible for compliance breaches in the firm. This responsibility is seen either with the board of directors or with the line managers (1. line of defence) | Inherent conflict between responsibilities of board of directors, Compliance Officer and Line Manager. Can lead to misconceptions about responsibility. | Board of director may not fully support the Compliance Officer, if it thinks that the Compliance Officer owns the responsibility for Compliance and vice versa. |
| Value conflict | Board of director is not supporting the firm´s internal policies and values and is thereby weakening normative motivations | Informants think that the board of directors is avoiding difficult decisions and is not fully supporting the internal policies and the Compliance Officer as an authority (no "tone from the top"). | Weakening of normative compliance motivation, as the highest managers in the firm are giving a bad example. | Board of directors, as well as certain other senior managers in the firm will not follow normative motivations. |

**Table 8***: Action/Consequence Matrix for the Two Conflicts in Relation to Compliance Behaviour.*

The following two conflicts could be clearly identified:

- Responsibility conflict: Informants think that the Compliance Officer should not be held responsible for compliance breaches in the firm. Compliance Officers see this responsibility with the board of directors or with the line managers (1. line of defence). At the same time, the board of directors and the various line managers in these companies seem to expect that this responsibility rest with the Compliance Officers.
- Value conflict: Informants think that the board of directors is avoiding difficult decisions and is not fully supporting the internal policies and the Compliance Officer as an authority ("tone from the top" is not sufficiently supporting a good compliance behaviour).

These conflicts are important to note, as they could significantly influence the effectiveness of internal compliance management systems. As explained in detail in the sections above, asset management companies have established compliance management systems in order to build a “bridge” between compliance behaviour on the macro and the micro level. This is necessary, in order to ensure that each individual employee acts in accordance with the rules and regulations that apply to

the companies as organisations and helps to solve the classical principal/agent problem existing in hierarchical organised companies.
If these systems are flawed by conflicts regarding responsibilities and values, they may fail to work as an effective mechanism to ensure proper compliance behaviour. These conflicts were not discovered during the analysis in phase 2 of the research project. The discovery of these conflicts in phase 3, therefore, adds another dimension to the results found in relation to how compliance behaviour looks.

## Part 2. Motivations for Compliance

In addition to exploring how compliance behaviour actually looks in asset management companies, a central part of the empirical enquiry aimed to explore how different motives influence the compliance behaviour of a complex organisation such as an asset management company. Consequently, the question what motivates compliance behaviour in a firm was discussed in all interviews.

While the previous section has laid out the findings that were made in connection with questions linked to "What does it look like?" and "How does it actually work?", the following section will provide an overview about the findings that have been made to answer the "Why?" questions. As shown in the below diagram, the interviews revealed codes that circle around different motivations for compliance behaviour. These codes have been inducted from incidents found in the interview transcripts, which were linked to economic, social or normative motivations for compliance behaviour in asset management companies. The findings will be laid out in the following in some detail.

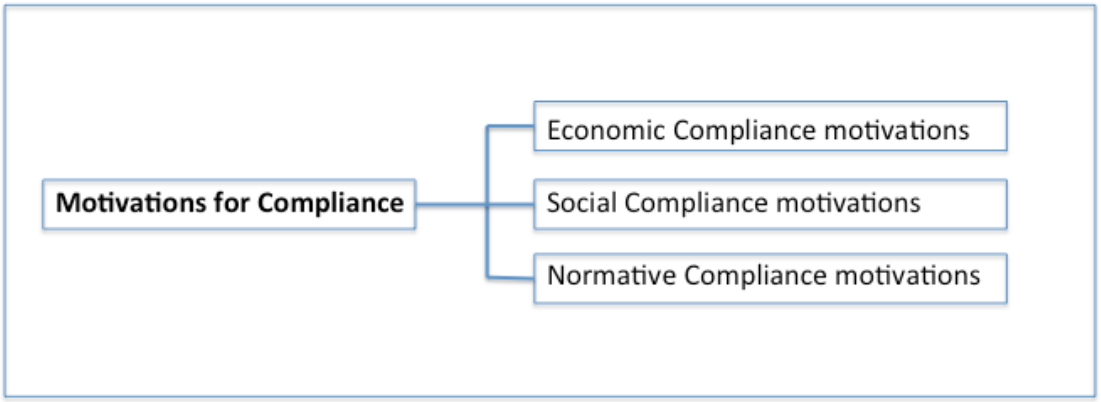


**Fig. 20***: Thematic Categories Linked to the Broader Theme "Motivations for Compliance".*

## 1. Economic Compliance Motivations

Many informants expressed the view that economic motivations are the predominant motivations for the compliance behaviour of most companies.

Incidents related to economic compliance motivations were related to examples of deterrence or to limitations of deterrence of regulatory sanctions. Figure 9 below illustrates how these incidents were inducted into the thematic category "Economic compliance motivation".

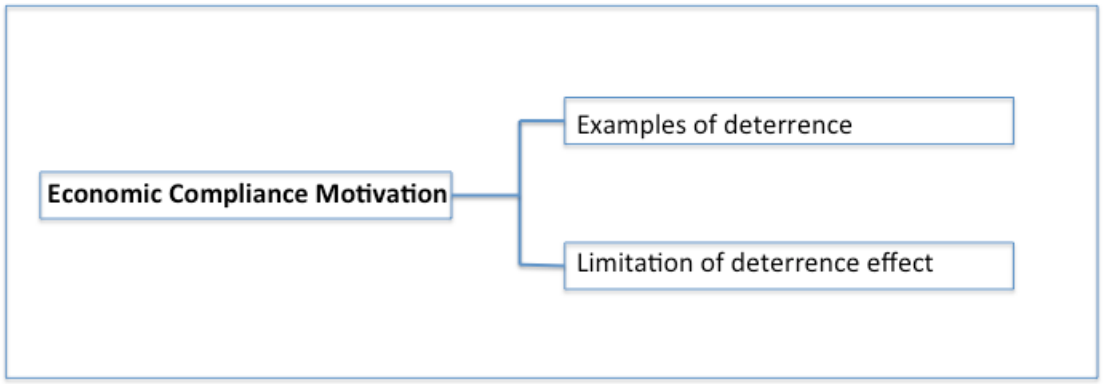


**Fig. 21***: Incidents/Codes of the Thematic Category "Economic Motivation".*

Examples of deterrence related largely to the fear of sanctions and personal liability. Informant 7 did express his view as follows:

*"I believe that the risk of personal liability of the company managers is a strong motivation for good compliance in a firm. Managers of the firm would, for example, be held personally liable in case of significant failures of the internal "systems and controls" or also in relation to data protection issues."*

### *Cultural Differences*

The majority of all informants mentioned the fear of being sanctioned by a regulator as strong motivation for compliant behaviour. However, there might be cultural difference between the UK and Germany. Informant 4, having experience in international firms, provided the following view:

"*A critical consideration in my view is the fear of sanctions. This is the case at least in the financial services industry. In the Anglo-Saxon world fear of personal culpability and liability is another strong motivator – in Germany personal liabilities are rather rare and people don´t fear them. I believe that if people don´t need to fear*

*punishment for wrongdoing then they have a strong tendency not to worry about compliance. If, on the other hand a powerful regulator is supervising the market and people fear that their wrongdoing may have serious consequences for them, they have a strong interest to do everything right and compliance is important for them.*"

According to this account the risk for personal liability for wrongdoing is considered much higher in the Anglo-Saxon world (UK and USA).
The interviews indicated that there is a fear of being sanctioned by a regulator for non-compliant behaviour. While a regulator can impose a sanction on a firm as such or even on an individual manager within a firm it is not surprising that the fear for personal sanction (e.g. in the form of a warning letter or even a financial penalty) is especially seen as a relevant motive for decision makers to ensure that the firm complies with all relevant regulations.

### *Differences Between Micro and Macro Level*

Considering that companies are systems comprising of multiple individual people, who could be relevant for decision-making, the question arises whether the fear of sanctions would also have implications on a "macro level" for the organisation as such.
Informant 6 provided an account that indicates that the fear of sanctions has also implications on a level that goes beyond individual decision makers:

*"What motivates a company to comply with laws and regulations? Two points: Financial sanctions and reputational damages. For example, Blackrock was recently sanctioned by BaFin (in Germany) to pay 1 million Euro fine for wrong disclosures of important shareholdings in listed German companies. This was the highest sanction that BaFin has ever fined against an Asset Manager in Germany and it had immediately raised awareness of the topic (important shareholding disclosure) within the industry."*

Besides the threat for personal liability of the company´s senior managers, financial penalties and the risk of reputational damage affiliated to such sanctions are apparently considered as another important factor that motivates the compliance behaviour of a firm.

Informant 5 echoed the relevance of reputational damages in the following account:

"*One risk that a company faces in case of non-compliance is a possible financial sanction. Even more important is that regulators will make sanctions fined to a*

*company public on their website. This can cause a significant reputational damage to the company that received a financial sanction."*

Informant 5 also provided a good insight into how regulated companies estimate their perceived regulatory risk:

"[…] *Consequently, weak processes can always cause reputational risks to a firm. If the risk that something goes wrong within a weak process is high, then the affiliated reputational risk is high, as well. One example of such a critical process is for me the process for identifying and reporting important shareholdings to the regulator. This process requires a firm to monitor its holdings in all listed securities and file reports to the competent regulator, if certain thresholds are reached. The problem with this process is that a firm can only monitor its holdings "ex post" (i.e. after all transactions have been booked within the accounting system). As regulators have set very tight deadlines for firms to file such reports (e.g. in some cases on the same day a trade was executed), there is a high risk that thresholds may be detected and reported too late. Regulators will then immediately file a fine against a firm*."

If a certain process bears the risk of failure and in consequence the company might face a financial sanction and affiliated reputational damage, it will often consider such process as high risk. If potential sanctions and reputational damage are considered as significant, the company will very likely be willing to invest money and resources to mitigate such a risk.
That means that the deterrence effect created by the fear of being sanctioned from a regulator is different for the fear of personal liability and for the fear of "un-personalised" sanctions on the company. On a company-level this fear is treated similarly to an economic risk. Processes with high potential for failures that can result in regulatory sanctions are clearly identified and as "high risk" processes. The process for filing of important shareholding notifications is a good example for such a process.

### *Signalling Effects and Reputation*

Another interesting fact about the interview with informant 5 is that the informant suggested that whenever a peer company is sanctioned by a regulator this causes an immediate "signalling-effect" to other companies in the same business segment (e.g. asset management companies in Germany reacted to BaFin fine against Blackrock). Regulators could potentially utilise this signalling-effect in order to enhance deterrence.

Another important observation was that a potential reputational damage caused by a sanction is often considered more important than the actual financial impact of the penalty. Informant 13 again emphasised on the strong motivation that comes with the risk of reputational damage:

*"Whenever an issue is detected that could impact the firm´s reputation I see a strong will to invest and to do whatever needs to be done to avoid a reputational damage. Otherwise I see a tendency to only do as much as needs to be done at a minimum. Of course, compliance and risk management are also a question of costs. It is however very difficult to calculate cost and benefit in this area. If a company for example decided to hire one additional Risk Manager, it could be that this person detects a risk that would have been overlooked otherwise and thereby saves the firm costs in the value of one- or two-yearly salaries. This is something you cannot know in advance. For compliance this situation is similar. Managers are used to calculating costs for a new investment and estimated profits. This does not work in the case of compliance. Here they have to calculate with costs for a new investment and estimate potential losses saved by this investment. This is difficult to estimate and also difficult to measure*."

Informant 13 thereby provided another deep insight into the actual risk-estimation of regulated companies. One interesting point to note is that he explained that potential financial sanctions and the costs of reputational damages are very difficult to estimate. This difficulty might cause companies to underestimate the risk and thus to treat for example certain process risks (e.g. in relation to regulatory reporting requirements) with less priority than they might deserve in the eye of the regulator. Generally, the fear of reputational damage is linked to the fear of indirect financial consequences caused by either the consecutive loss of existing clients or by the increased difficulty to get new clients, after a regulator had sanctioned a firm. This is important to understand, as it means that the demands of clients for a company that performs its business in an orderly fashion and in line with all relevant laws is actually a strong driver for a company to invest into a good compliance-culture. Many informants mentioned explicitly that client demand for a strong compliance culture is considered an important driver for compliance behaviour. For example, informant 2 mentioned that potential new clients would often request to see and review the firm´s internal compliance policies or speak with a Compliance Officer before money is invested. Other informants also echoed this. Informant 4 believed that certain clients would not even consider conducting business with a company that had been sanctioned by a regulator. Informant 6 echoed this and explained his view as follows:

"*There is nearly no other business area where clients can withdraw their money so quickly, as in the asset management industry. That means, if your reputation is damaged you will face significant outflows of client money already the following day and you will be unable to control such a situation."*

### *Conclusions about Economic Motivations*

In sum, it can be concluded that economic motivations in the form of deterrence by sanctions imposed on companies for non-compliance behaviour are a strong motive for compliance behaviour. The deterrence effect is stronger in relation to personalised sanctions, and less significant for un-personalised sanctions imposed on a company.

The company´s managers see this as an economic risk that relates to the operations of their business. Some processes are more likely to fail and thereby to lead to sanctions, than others. The companies estimate this risk and additional resources are invested in order to support "high risk processes" (e.g. by investing in better IT systems, etc.).

Interestingly, there seems to be cultural differences between the deterrence effect in Germany and the UK. Both, German and UK-based informants indicated that the deterrence effect created by sanctions imposed by the regulator is stronger in the UK, than in Germany.

Lastly, the deterrence effect is significantly influenced by the fear of losing clients (and the ability to win new clients) by the bad reputation that goes along with a public sanction by a regulator.

## 2. Social Compliance Motivations

Other incidents of motivations for compliance behaviour identified in the interview data did not relate to economic motives. These incidents were often related to social compliance motivations. Figure 11 below illustrates how these incidents had been inducted into the thematic category "Social Compliance Motivations".

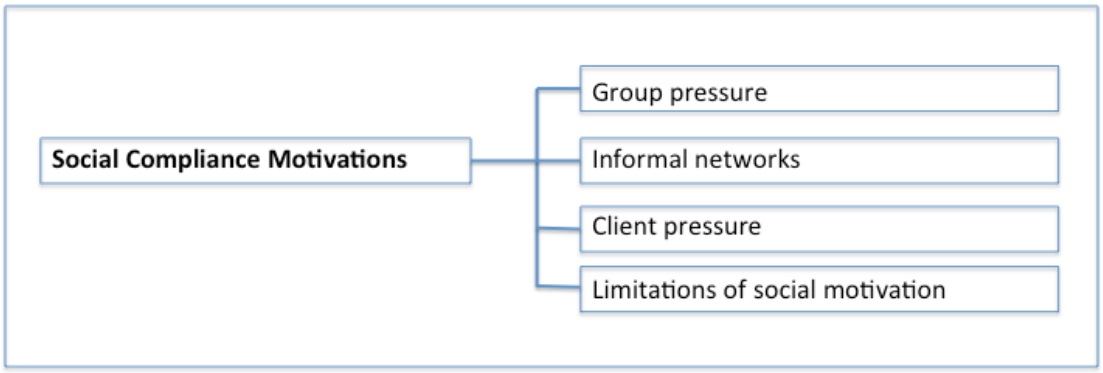


**Fig. 22:** ***Incidents/Codes of the Thematic Category "Social Compliance Motivations".***

### *Internal Networks and Group Pressure*

Many informants mentioned that an informal exchange with other peer companies was very important for them. For example, informant 5 explained the following:

"*Besides internal risk considerations, exchange with other firms e.g. within the industry association can be relevant. Some differences between the different firms must, however, be taken into account: If, for example, a very large company decides to implement a complex new IT system to provide better internal compliance-training for their employees, this does not mean that a smaller company would also need to implement such a system.*
*Nevertheless, the exchange in informal networks can be very helpful – specifically, if it relates to the understanding of planned new regulation.*"

Industry associations in Germany ("Bundesverband der Investmentmanager" and the UK "Investment Industry Association") provide an ideal platform for such informal exchange of ideas. It is apparent that this form of exchange also has implications on the firm´s compliance behaviour, as they will learn new ideas and perspectives that they will also consider relevant for their own company.
Furthermore, this kind of informal exchange can also produce "peer pressure" between different firms: If all firms in the debate have a certain view about what should be done to be compliant with a specific regulation, it becomes very difficult

for one single firm to follow a different view without "losing face" to representatives of the peer companies. This group pressure increases, if firms mention that they had already spoken with auditors, external consultants or even the regulator in order to validate their view, as it then becomes difficult to defend a different view. However, reporting about discussions with regulators by individual representatives of a firm can still be useful for others. For example, informant 7 noted:

"*Sometimes a firm may already have spoken with the regulator about a specific topic and can report about this*."

It looks like exchange with peers is a double-edged sword. On the one hand firms can benefit from new ideas and the experiences of their peers. On the other hand, this can also lead to a situation of pressure, which could be a strong motivation for a firm to pursue a certain direction.

### *Clients and Social Motivation*

Some incidents in the data suggested that social motivation could also be derived from clients. Informant 11 provided the following example:

"*EMIR is a good example – the reporting requirements for complying with EMIR is a requirement for the client – the client is liable to provide the reporting – but, if we took on that duty on behalf of the client – the client has kind of outsourced the reporting to us. So, you could say that EMIR reporting for us is more an obligation to the client and not because of the rule. It meant a lot of work such as IT development and changes to our systems to become able to do the EMIR reporting. So that is a big obligation that we took on behalf of the client."*

The example of informant 11 illustrates that there are certain situations in which clients can put pressure on a firm in order to motivate it to comply with specific requirements, even if these would not be applicable to the firm.

### *Conclusions about Social Motivations*

It can therefore be concluded that social motives are of great relevance for the compliance behaviour of asset management firms. The individual managers within these firms who are responsible for ensuring that the firm´s business is conducted in a compliant manner meet regularly with peers to exchange their views. These meetings are partly organised by the industry associations and partly rather informal discussions within the personal networks of these managers. Social motivations are

especially relevant in relation to the behaviour towards new regulatory requirements. If no one really knows the risk related to new regulations or new business activities, the peers align in order to develop a joint approach. Peer pressure was identified as important: If the majority of the firms within the peer group position themselves in a certain direction it becomes difficult for the managers of other firms to justify a different position towards their internal stakeholders.

Also, client demand was identified as a relevant social motivation. Some companies are obviously willing to commit themselves to additional requirements not because of any regulatory requirement, but simply to fulfil their client´s needs.

## 3. Normative Compliance Motivations

Normative motivations relate to "internalised" normative values, such as legitimacy and personal morals as relevant factors for decision-making towards compliance behaviour. Normative motivations were not as easy to discover in the data. Multiple informants expressed the belief that moral values are of little importance for compliance behaviour in the asset management industry. For example, informant 2 stated:

"*I believe it is a mixture of different factors, which motivate compliance behaviour (in the asset management industry). Moral values are of least importance – you can see that at church – Moral values are only an ideal picture of the reality. It would be a lie to tell you that we are now doing this or that simply for its moral value*."

It is an interesting observation, that the informants deny the relevance of moral values for compliance behaviour. As pointed out by Guillen, Karelaia, and Leroy (2016), although individuals feel authentic, when they act consistently with their values, others do not necessarily also see them as authentic. And, while this could point to such an "authenticity-gap" within the top management of the organisations (i.e. the Compliance Officers do not truly believe what the top management communicates about norms and values), this does not necessarily mean that normative motivation is really irrelevant in the data. Often informants may not even be aware that it is their own moral values, which motivates certain actions.
In fact, the interview data provided examples of situations related to personal value perceptions. These incidents were inducted to the category "Normative Compliance Motivations" – although not directly expressed as such by the informants during the interviews. Figure 23 below illustrates how these incidents had been inducted into the thematic category "Normative Compliance Motivations".

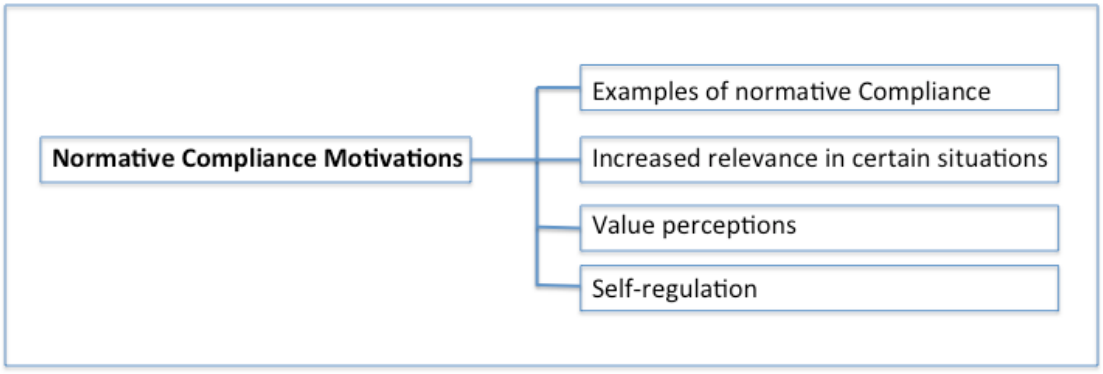


**Fig. 23***: Incidents/Codes of the Thematic Category "Normative Compliance Motivation".*

### *Self-Motivated Compliance Behaviour*

Many informants explained what "compliance culture" would mean to them. When they provided their explanations about what this means, it became evident that moral values actually play an important role for them. For example, informant 7 provided his view about the compliance behaviour of individual employees within a regulated firm ("micro level"):

"*The perfect compliance-culture was, if I (the Chief Compliance Officer) would be redundant because every employee ensures compliance with the law. This aim can, however, not be achieved in reality. More realistic is to achieve a good compliance-culture by creating an environment that encourages all employees to internalise all relevant regulations and take them seriously."*

In other words, compliance behaviour would be flawless, if all employees within a firm internalised all relevant regulations (and the moral values that these represent) and thus acted in perfectly compliance with them. This was thought of as the ideal situation that cannot be achieved in the reality of a company.
Because they believed in such an ideal but had little confidence in their employees´ ethical values, many informants emphasised the importance of a proper compliance organisation. This organisation consists of internal compliance guidelines for ethical behaviour and aimed to help employees avoid violations of all relevant regulations. Most informants regarded compliance training as extremely relevant for creating a good compliance culture. For example, informant 1 explained it as follows:

"*In my view compliance training is of utmost importance. The Compliance Officer explains not only the regulation, but also why it is important to comply with the regulation. Especially, with regards to the rules for personal account dealing it is not always easy to understand why these are important. Not every breach of our internal rules regarding the personal account dealing of our employees is automatically a crime. In fact, our internal compliance handbook is much stricter than what would be legally required and consequently not every violation of our compliance handbook is automatically a breach of statutory regulation.* "

Clearly, training is seen as a tool to transmit normative values to individual employees. Thus, it is apparent that normative motivations are considered an important factor for the compliance behaviour of individual employees within a firm. Compliance training is supported by a compliance handbook or "code of ethics", which all asset management firms have developed for their employees.

### *Corporate Values and Normative Motivations*

Some firms have developed internal compliance rules, which go even further than required by the law. The reasoning for this is two-fold: On the one hand firms want to protect their reputation and may therefore decide to restrict employees even more than it would be required under the law in order to avoid situations that are no violation of a law, but could still be negative for the firm´s reputation. This was the reason provided for example by informant 1.

On the other hand, firms also appear to develop their own internal value systems and then add limitations for their employees based on this value system (rather than purely based on the law). For example, informant 7 stated:

"*Successful companies always have their own values. For asset management firms these values are often (and much more than for banks) focussed around sustainability. An asset management firm obtains money from clients and manages it sometimes for a period of 20 to 30 years. Consequently, the sustainable investment of this money benefits the firm and the client.*"

If firms develop their own internal values, it is not surprising that they aim to transmit these values also to their employees.

Another instance that indicated the existence of internalised moral values can be seen in industry-wide self-regulation. Informant 4 explained that the German asset management industry had once developed an industry code of conduct ("BVI Wohlverhaltensregeln"), which should incorporate the joint values and oblige all German asset management companies to adhere to these values on a voluntary base. This indicates that local industries are also capable of developing their own unique value systems.

### *Conclusions about Normative Motivations*

In summary, normative motives are an important determent for compliance behaviour within asset management firms. In an expert interview such normative motives can, however, not be seen "on the surface".

Only the context of various interviews reveals that companies do have their own internal value system, often even encoded into a compliance manual, code of ethics and potentially even incorporated into voluntary industry rules. The ethical values are the underlying rationale for such internal rulebooks. The interviews showed that asset management companies have a tendency to incorporate rules for their

employees that sometimes go beyond regulatory requirements. The rationale for this behaviour is, however, not necessarily “good morals”. It seems more likely that these internal rules (and thus the underlying values) are simply another form of risk management for these companies. For example, a gas station will likely prohibit smoking although the law does not prohibit smoking. Likewise, asset management companies may prohibit certain conduct of their employees that could cause the risk of regulatory sanctions, such as personal account dealings.

Furthermore, the responsible managers within these firms surely have their own moral values and are motivated to act in accordance with these. For example, they stated the expectation that compliant and lawful behaviour should be an automatism, even if no Compliance Officer would be there to enforce good conduct.

Unfortunately, the experts interviewed were unwilling to reveal their personal values in more detail during the interviews, so that it was impossible to conclude much more than the bare fact that such values do exist.

## What Can Be Concluded about Motivations for Compliance?

The concept "Motivations for Compliance" was developed from a standpoint that views compliance behaviour as exogenous to the research and by linking three thematic sub-categories "Economic Compliance Motivations", "Normative Compliance Motivations" and "Social Compliance Motivations". As such the concept presented here resembles the same core features of the holistic and plural model of corporate compliance according to (C. Parker & Nielsen, 2017).
All three motives are relevant for the compliance behaviour of asset management companies.
Again, the different phases of the research study contributed differently to the understanding of the findings. Line-by-line coding used only in phase 3 inspired the idea that the informant´s internal thinking about different motivational factors and the consequences for the firm were evident in the data but had not yet been systematically analysed.
Consequently, focussed coding was used in order to identify codes that revealed the informant's internal thinking about motivations for compliance as a next step after line-by-line coding. The table in appendix 4 illustrates these codes and puts them in relation to the relevant thematic sub-categories, categories and internal thinking.
The analysis showed that in relation to motives for compliance behaviour the informants had the following internal thinking:

- Informants think that the fear of losing the ability to do business motivates the firm to remain compliant with all relevant laws (economic motive).
- Informants think that their companies fear being sanctioned for weak compliance controls, as this will cause a reputational damage and impair the ability to win or retain clients (economic motive).
- Informants think that external auditors act as agents of the regulator and fear that they could report weak compliance controls, which could lead to financial sanction or reputational damage (economic motive).
- Informants think that companies fear being discovered in having less advanced systems and controls that ensure compliant behaviour than most other peers have (social motive).

- Informants think that all employees and department leaders fear personal consequences, if they fail to meet the firm´s internal policies/1. line of defence (normative motive).

In other words, the analysis showed that the internal thinking of the informants in relation to motivations for compliance behaviour is linked to specific actions and outcomes. Therefore, an Action/Consequence-matrix was used as a tool for further analysis of these relationships (see table below).

| **Category** | **Context** | **Internal thinking** | **Action, interaction, emotion** | **Consequence, Outcome** |
|---|---|---|---|---|
| Economic motive | loosing license due to non-compliant behaviour | Informants think that the fear of losing the ability to do business motivates the firm to make sure to be compliant with all relevant laws ("macro level") | Firm will invest in Compliance Management Systems and support the Compliance Officer ("macro level") | Firm will develop in a way to ensure sufficient internal controls and will nurture a good Compliance culture ("macro level") |
| Economic motive | being sanctioned for non-compliant behaviour | Informants think that companies fear being sanctioned for weak compliance controls, as this will cause a reputational damage and impair the ability to win or retain clients ("macro level"). | Firm will invest in Compliance Management Systems and support the Compliance Officer ("macro level") | Firm will develop in a way to ensure sufficient internal controls and will nurture a good Compliance culture ("macro level") |
| Economic motive | being discovered for non-compliant behaviour | Informants think that external auditors act as agents of the regulator and fear that they could report weak compliance controls, which could lead to financial sanction or reputational damage ("macro level") | Firm will invest in Compliance Management Systems and support the Compliance Officer ("macro level") | Firm will develop in a way to ensure sufficient internal controls and will nurture a good Compliance culture ("macro level") |
| Social motive | being discovered to have weaker Compliance controls than others | Informants think that companies fear to be discovered in having less advanced systems and controls to ensure compliant behaviour than most other peers have ("macro level") | Firm will participate in working groups with industry associations and other informal networks to make sure it is known and understood what peers are doing to be compliant ("macro level") | Firm will try to influence peers by setting their own "best practise" standards and try to prevent peers from setting very high industry standards ("macro level") |
| Normative motive | desire to develop internal values and rules within the company (e.g. failure to comply with Code of Ethics) | Informants think that all employees should be self-motivated to meet the firm´s internal policies ("micro level") | Firm will adopt internal policies, processes and provide training to staff to ensure that all staff lives up to the firm´s internal values ("micro level") | Firm will develop internal policies/procedures, establish a Compliance Officer and provide training to staff ("micro level") |

**Table 9***: Action/Consequence Matrix for Compliance Motivations.*

The matrix analysis allowed some new observations in the three areas of economic, social and normative motivations:

Economic Motivations:

- Informants think that the fear of losing the ability to do business motivates the firm to remain compliant with all relevant laws ("macro level").
- Informants think that firms fear being sanctioned for weak compliance controls, as this will cause a reputational damage and impair the ability to win or retain clients ("macro level").
- Informants think that external auditors act as agents of the regulator and fear that they could report weak compliance controls, which could lead to financial sanction or reputational damage ("macro level").

All three factors will, however, lead to the same action: Firms will invest in compliance management systems and support the Compliance Officer in order to avoid the negative outcome.
Firms will therefore be motivated to develop ways to ensure sufficient internal controls and will nurture a good compliance culture ("macro level").

Social Motivations:

With regards to social motivations the internal thinking of the informants shows that companies fear being discovered in having less advanced systems and controls to ensure compliant behaviour compared with most other peers ("macro level"). This thinking leads to the following action: Firms will participate in working groups with industry associations and other informal networks to make sure it is known and understood what peers are doing to be compliant. This action will result in the outcome that firms will try to influence peers by setting their own "best practice" standards and try to prevent peers from setting industry standards that are unfavourable for their respective companies.

Normative Motivations:

The internal thinking in relation to normative motivations relates to the idea that all employees should be self-motivated to comply with the firm´s compliance rules, as these should incorporate the shared values of the firm and its employees. This thinking leads to the action that firms will adopt internal policies, processes and provide training to staff to ensure that all staff live up to the firm´s internal values. The outcome of this action then is that firms will develop internal policies/procedures, establish a Compliance Officer and provide staff training ("micro level").

It can therefore be concluded that economic and social motivations are actually determined by external factors, while normative motivations are more dependent on internal factors (e.g. corporate values), which are relevant on the micro level. This observation was not obvious during the analysis in phase 1 and 2.

## Chapter Summary

The findings of the in-depth expert interviews are twofold:
Firstly, the interview data provided rich information about what motivates compliance behaviour. Secondly, the data showed very vividly how compliance behaviour actually looks within asset management companies.
The following list is a summary of the key findings that have been made in these two areas:

What Motivates Compliance Behaviour?

1. A number of **external economic motivations will influence a company´s compliance behaviour on an organisational level** (the following motivations were identified: fear of losing licence due to non-compliant behaviour, fear of being sanctioned for non-compliant behaviour and fear of being discovered for non-compliant behaviour). There are however cultural differences that lead to the stronger or weaker deterrence effect of economic sanctions imposed by regulators.
2. **External social motivations will also influence a company´s compliance behaviour on an organisational level** (the motive here is peer pressure, as no company would like to be discovered in having weaker compliance controls than its peers).
3. **Normative motivations are important factors for the internal motivation of Compliance behaviour of individual employees** (companies develop internal value´s e.g. code of ethics and these normative values influence the actual compliance behaviour of individual employees).
4. **A number of internal and external stakeholders influence the compliance behaviour of companies on an organisational level and of individual employees** (e.g. regulators, external auditors and consultants will influence the compliance behaviour on an organisational level, while the board of directors, the Compliance Officers and the legal department will have a strong influence over the compliance behaviour of individual employees).

What does Compliance Behaviour Actually Look Like?

1. It is difficult for larger or multinational firms operating their business in environments as highly regulated as the asset management industry to always know each relevant regulation and to ensure that these rules are all embedded within the firm´s policies and procedures / the firm´s actual compliance behaviour. Therefore, these firms will usually have **designated employees (often the Compliance Officer) who are tasked with monitoring external regulatory developments as well as internal changes** within the business organisation and ensure that all relevant rules and regulations are known and adhered to within the company.
2. Compliance behaviour is not static for highly regulated companies. Instead, regulators and lawmakers are constantly developing new rules and these companies have to adjust their business processes accordingly. In order to do so they will normally set up a **regulatory change project** (often led by the Compliance Officer) in order to make systematic changes of the firm´s business processes in order to ensure compliance with new rules.
3. Regulated companies are faced with the problem that they have to ensure that all employees within the firm adhere to the rules that are relevant for the company as an organisation. This is a classical problem of the relationship between a principal (i.e. the board of directors of the company) and agents (each individual employee). **In order to solve the principal/agent problem, regulated companies will develop compliance management systems** which will differ to the size and complexity of each company and which are often administrated by the Compliance Officer. These compliance management systems are designed to cascade responsibility downward to each individual employee (1. line of defence). They include mechanisms for monitoring how well each employee is discharging this responsibility (2. line of defence) and are often subject to internal supervision by auditors (3. line of defence).

4. The **effectiveness of internal compliance management systems may be impaired by conflicts of interest** between the board of directors as ultimate principal and the Compliance Officer administrating these systems as agents, as well as between the Compliance Officer as Principal and individual employees (or line managers) as agents. The key issue here is that the board of directors may want the Compliance Officer to be responsible for the actual compliance behaviour of the lowest agents in this chain (each individual employee). At the same time the Compliance Officer views himself as an agent to the board of directors and is unwilling to take on full responsibility for the conduct of each employee.

How these findings add to the existing body of compliance theory and which new theories can be developed from them will be discussed in detail in the following chapter.

# Chapter VII – Discussion and Development of Theory

*If data can be said to exist at all, data is the stuff of which by definition human beings are unaware. (Bryant, 2002)*

According to Bryant human beings cannot engage directly with data. One can copy a book without being able to read the language in which it is written. But, "reading" a book is quite different and means exchanging ideas and to constructing meaning. The construction of meaning from data is at the centre of qualitative research and particularly GTM.

As already laid out in detail in earlier chapters, GTM is a dynamic research method. Collecting data by conducting interviews, analysing data and constructing meaning from these data all happen simultaneously. Consequently, the findings presented in the previous chapter are in fact not simply data. These findings are a mix of "raw" data (i.e. codes that were identified in the interviews) and "meaning" (i.e. logical conclusions that were made throughout the process).

While the previous chapter provided an overview of the relevant data and how meaning was made through systematic analysis, the present chapter aims to illustrate in clear terms the construction of theories.

Much like the previous chapter, this chapter is split into two parts. Part 1 will explain the development of theory in the context of compliance motivations and part 2 will illustrate the development of theory in the context of compliance behaviour.

## Part 1: Theory in the Context of Compliance Motivations

The first part of this chapter will deal, in more detail, with the findings presented in the previous chapter regarding compliance motivations. Based on these findings, it will be demonstrated how theories that help to understand "why" companies comply with regulation have been constructed.

The following findings were explained in the previous chapter in more detail:

1. External economic motivations will influence a company´s compliance behaviour on an organisational level ("macro level"). Economic motivations are, however, strongly linked to fines imposed by a regulator and by the fear of reputational damages. There are strong indications that the fears of such fines imposed by a regulator are subject to cultural differences between Germany and the UK.
2. External social motivations will also influence a company´s compliance behaviour on an organisational level ("macro level").
3. Normative motivations are important factors for the internal motivation of compliance behaviour for individual employees ("micro level").
4. A number of internal and external stakeholders influence the compliance behaviour of companies on an organisational level ("macro level") and for individual employees ("micro level").

## External Forces

These findings are grounded in the interview data. Two of these findings relate to the motivations that have proven to influence compliance behaviour at a macro level. This leads to the conclusion that compliance behaviour on a macro level is mainly a function of economic and social triggers. The following can thus be theorised:

*Economic and social factors can motivate the compliance behaviour of asset management companies on an organisational level ("macro level"). Particularly the effect of economic factors may vary between different cultures.*

The figure below provides a complete illustration of the different forces that were identified in the previous chapter in connection with economic and social motivations.

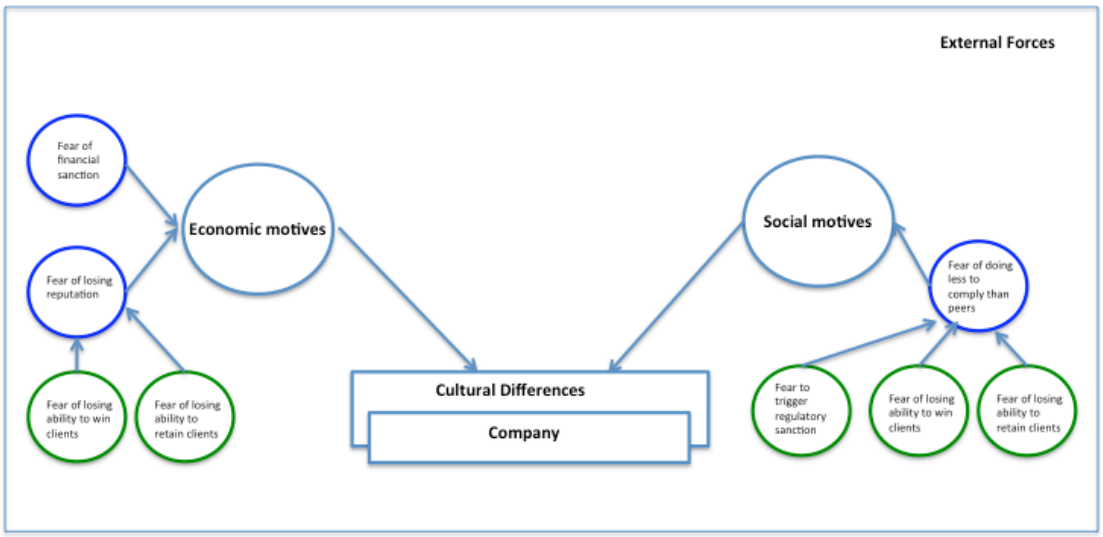


**Fig. 24:** ***Illustration of How Economic and Social Motivations Influence Actions of a Company from the Outside ("Macro-Level"). The "Arrows" Indicate the Flow of Different Motivational Forces.***

### Internal Forces

Furthermore, finding 3 has shown that normative motivations are important factors for the internal motivation of compliance behaviour for individual employees ("micro level"). This does not mean, that compliance behaviour on a micro level is not also influenced by economic and social motivations. It does however mean, that normative motivations are less likely to influence compliance behaviour on a macro level. This allows further theorising:

*Economic and social forces can motivate the compliance behaviour of asset management companies on an organisational level ("macro level"), while normative motivations are particularly relevant forces for compliance behaviour within an organisation ("micro level").*

Although it seems that social and even economic motives may potentially play a role at a micro level (e.g. if individuals within a firm are motivated to violate a rule for economic benefit), the findings suggest that normative motivations play a particularly important role in determining the compliance behaviour of individuals within a firm.

Furthermore, finding 4 indicates that there are a multitude of internal and external stakeholders, which may have indirect – and often normative – influence over the compliance behaviour of individuals within a firm. Particularly, the board of directors will set the "tone from the top" and will thereby signal to employees the importance of ethical values. These signals include hints about the importance of compliance behaviour (e.g. Is it O.K. to violate internal rules in favour of profit or is that clearly not tolerated by the board?).

The Compliance Officer is another important stakeholder who will help to foster normative compliance behaviour (e.g. by explaining the rules and establishing a culture of "procedural justice" within a firm).

External stakeholders, such as clients, also hold a strong influence over normative compliance behaviour, as they will signal what kind of compliance culture they expect. And even competitors have been found to provide motives for compliance behaviour, as they will set certain standards that no one wants to fall short of (e.g. certain voluntary compliance rules used by one company can motivate other companies to follow this example). A complete list of all relevant internal and

external stakeholders and how they influence compliance behaviour within a firm on micro level is provided in appendix 6.

The figure below provides a complete illustration of the different internal forces identified in the previous chapter in connection with normative motivations. The figure also illustrates, how normative motives transmitted top-down from the board of directors influence the compliance behaviour of a company.

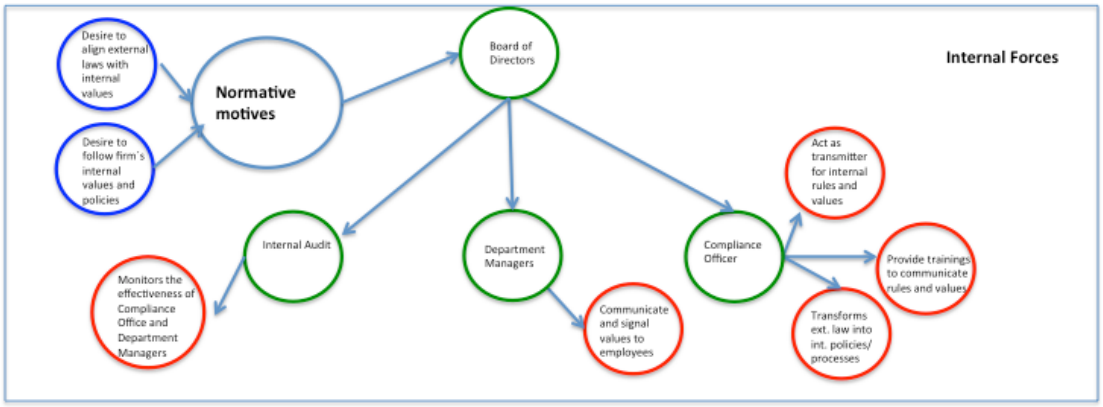


**Fig. 25***: Illustration of How Normative Motivations Influence Actions of a Company from the Inside ("Micro Level"). The "Arrows" Indicate the Flow of Different Motivational Forces.*

## Links Between External and Internal Forces

It is important to note that external motives existing on a macro level can transform into internal motives on a micro level. Such a transformation is possible, if specific stakeholders within a company are in a position to (1.) be influenced by motives that are only relevant for the company on a macro level and (2.) have the power to set motivations for compliance behaviour for individual employees within a company on a micro level.

If we assume that the board of directors is the official representation of the company on a macro level (i.e. the agent of the organisation) it means that the board of directors will likely respond to economic and social motivations that may exist on a macro level (e.g. if the board of directors fears personal economic disadvantages if the company violates a law, they will react to such an economic motivation). At the same time, the board of directors has the power to influence compliance behaviour within the company by providing resources to the compliance department and by setting the "tone from the top").

The board of directors is therefore a link between external and internal factors that determine compliance behaviour within a company.
Depending on the specific structure of a company there could also be other stakeholders, which can fulfil these two conditions and can thus act as a link between external and internal factors. However, the board of directors will by definition fulfil these conditions and can therefore be seen as such a link.
Such a link allows the development of a new Holistic Model of Motivational Forces, as shown in the below figure.

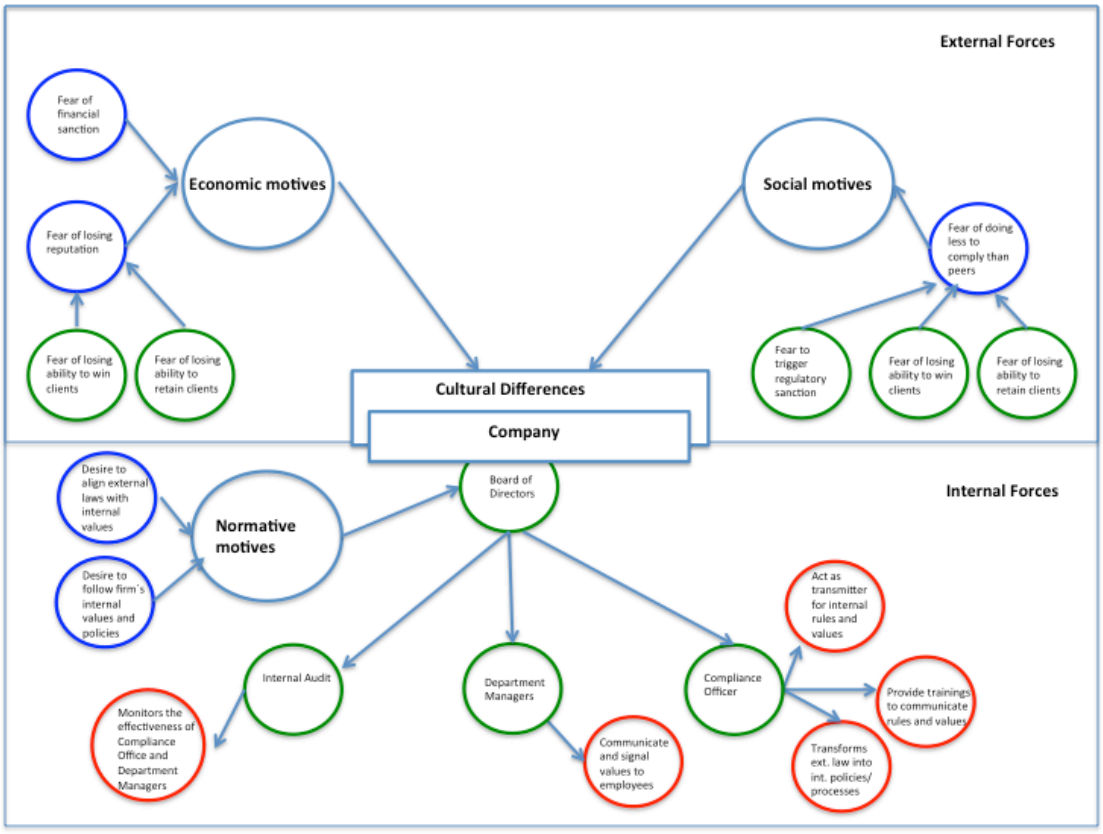


**Fig. 26: Holistic Model of Motivational Forces Influencing the Compliance Behaviour of an Asset Management Company.**

The above figure shows a model that illustrates how various forces within and outside the company will influence the compliance behaviour. In GTM language this model is an illustration of a new substantive theory, as it allows predictions about how different factors will influence the compliance behaviour of a company.

### About the New Holistic Model of Motivational Forces

The **new Holistic Model of Motivational Forces** influencing the Compliance behaviour is one of the main outcomes of the present study.

This model can be regarded as an advancement of the Nielsen-Parker Holistic Compliance Model (shown in fig. 5 above) and allows a much deeper understanding of how the various economic, social and normative motivations actually trigger compliance behaviour within an asset management company in Germany or the UK. In particular, the Nielsen-Parker Holistic Compliance Model did not provide a very nuanced specification of the ways in which the motives of an individual executive or employee in company relate to the company´s overall compliance behaviour, nor did it provide much details about the various stakeholders that are involved. The new Holistic Model of Motivational Forces, however, provides a much more refined understanding of how different economic, social and normative motives are the driving forces for the compliance behaviour of executives and many other stakeholders of a company.

In particular, by making a distinction between internal and external forces, the new model provides a new perspective on how various motivations influence the compliance behaviour of a company. The Nielsen-Parker Holistic Compliance Model did not make such a distinction and did simply assume that economic social and normative motivations are all influencing the compliance behaviour equally.

The empirical interview data collected as part of the present study showed, however, that economic and social motives are mainly driven by external forces, while normative motivations are driven by internal forces and by the desire to align external laws with internal values. This is an important advancement of the new model, as it shows that external stakeholders, such as auditors or regulators may have influence on a company´s economic and social motivations, but in fact, only a limited and indirect influence on a company´s normative motivations.

On the other hand, it was also found that normative motivations are seemingly seen as very significant motivations to ensure a good compliance behaviour by stakeholders within a company (e.g. companies aim to motivate employees to adhere to an internal code of ethics, which embodies the company´s normative values).

Additionally, the new model illustrates that economic and social motivations are often created by fear of certain consequences. For example, the economic motive to

act in accordance with relevant regulations in order to maintain the firm´s good reputation is driven by the fear of losing the ability to win new clients.
A strong social motivation for compliance behaviour was found in the desire to "do not less than the competitors" (e.g. if competitors support a new regulatory requirement by the implementation of new IT systems). Again, this motive is also driven by the fear of losing the ability to win new clients.
This is relevant to be understood in the context of a holistic compliance model, as it helps to understand how various stakeholders can influence economic or social motivations for compliance. For example, peer companies and clients have been found to be two important external stakeholders, which can drive a company's economic and social motivation towards compliance behaviour.
Also, other stakeholders, such as industry associations, consultants or auditors can influence a company´s motivations towards compliant behaviour. It was found that these stakeholders may interact with each other (e.g. a competitor may work with a certain consultant and this consultant can than influence the compliance behaviour of another company by driving the fear to do not less than the others). In this way, various stakeholders can have either a direct or indirect influence on the compliance motivation (and ultimately the compliance behaviour) of a company. A more comprehensive discussion of the roles of various stakeholders was provided in chapter VI above under the heading "Roles of Different Stakeholders". Furthermore, appendix 6 provides a full list of all internal and external stakeholders that have been identified in the present study and explains, how they can have a direct or indirect influence on the compliance behaviour of a company. Relating these stakeholders to the holistic compliance model allows a deeper understanding of the various causes of motivations for (or against) compliance behaviour of a company.
The new Holistic Model of Motivational Forces can therefore be used by policymakers to develop methods for enhancing compliance behaviour in the asset management industry.
Policymakers should consider the important role of normative motivations as internal forces for compliance behaviour and they should consider the direct and indirect influence of various external and internal stakeholders on economic and social motivations. They should further strengthen the importance of normative motivations within firms, by strengthening the role of an internal Compliance Officer as a transmitter of normative motivations. Regulators could even think of monitoring how

firms provide normative compliance motivations internally.
The fact that certain stakeholders, such as the board of directors act as a link to bridge between external and internal compliance forces is also of relevance. Policymakers should develop methods for monitoring more closely, how stakeholders in this position fulfil the role. For example, some larger companies tend to develop a complex legal structure with multiple holding companies between the board of directors and the actual operative entities. Policymakers could ask whether this could cause a situation in which a board of directors has become so remote from the actual operative business that it loses the power (or the interest) to set the right internal compliance motivations.
Furthermore, policymakers should also consider increasing the personal liability of the board of directors for any failures of the internal compliance behaviour on a micro level.
Moreover, the new model allows practitioners within such companies to have a more comprehensive understanding about the role of various stakeholders. This knowledge can help them to improve their internal compliance management systems.
Lastly, the new model provides much opportunity for future research. It would be particularly interesting and useful, to see if this new model can be used in the context of different industries (e.g. car industry, big data industry, etc.) and in different cultural backgrounds (e.g. USA or China).

## Part 2: Theory in the Context of Compliance Behaviour

While the first part of this chapter outlined the theories that have been developed in order to answer questions in relation to "why" companies comply with regulation, the second part will provide new theories to explain "how" compliance behaviour actually looks within regulated companies (i.e. in asset management companies). As illustrated in the previous chapter, the following conclusions were made from the interview data in the context of compliance behaviour:

1. Designated employees (often the Compliance Officer) are tasked with monitoring external regulatory developments as well as internal changes.
2. In order to deal with regulatory change companies will often set up a regulatory change project (often led by the Compliance Officer) in order to make systematic changes to the firm´s business processes in order to ensure compliance with new rules.
3. In order to solve the principal/agent problem, regulated companies will often develop internal compliance management systems which will differ according to the size and complexity of each company and which are often administrated by the Compliance Officer.
4. Conflicts of interest between the board of directors as ultimate principals and the Compliance Officer may impair the effectiveness of internal compliance management systems.

These conclusions are grounded in the interview data. By relating these conclusions to each other, the following theories in relation to compliance behaviour in asset management companies can be constructed.
Finding 1 and 2 show that asset management companies find it challenging to keep up with regulatory change. They thus build internal functions, which are responsible for monitoring, detecting and implementing changes required by new regulations. These findings allow theorising about a process-oriented Compliance model:

*Compliance behaviour will be influenced by the needs of a company to identify all relevant new regulations and implement required changes effectively within the organisation.*

This is relevant, as it means that (especially regulated) companies need to develop a process that enables them to detect the need for changes in their organisation, based on new regulations. Such a "change process" was illustrated in figure 19 in the previous chapter. As laid out above, this process ends with what is called "ongoing compliance oversight" in figure 19. It can be seen that the change process and the ongoing compliance oversight are (although connected) two very different processes, which involve different stakeholders.

Contemporary processual compliance models, such as the one developed by Root (2018), as illustrated in figure 4, seem to explain well how the ongoing compliance oversight works. They do, however, not explain any of the complexities that companies face, when they need to adjust their organisation to a new regulatory requirement. This is particularly relevant for regulated companies, which conduct their business in multiple different countries. As explained in chapter IV, asset manager companies with international business operations (e.g. in Germany and in the UK), have to adhere to diverse conduct requirements that may be different in different countries. These companies are confronted with the complex challenge to monitor various changing regulatory requirements and (where required) implement organisational changes. If this process fails, they will not even have the capacity to start the second process to ensure ongoing compliance oversight.

Regulators should consequently be aware of this issue and monitor, how companies deal with regulatory changes.

### Processes on Micro- and Macro Level

Furthermore, existing models, such as the one developed by Root (2018), do not venture into the difference between the compliance behaviour of a company as an organisation ("macro level") and the individuals within a company ("micro level"). Within a company the difference between what the firm has to adhere to on a macro level (as an organisation) and on the micro level (i.e. each employee) can be understood as a classical principal/agent situation. The board of directors have to ensure towards the regulator that all their department managers and all their employees adhere to all relevant rules. Finding 3 has shown that all asset management companies have consequently developed internal compliance management systems in order to bridge between the macro and micro level and to ensure good compliance behaviour on all levels of the firm. It can therefore be further theorised, as follows:

*Companies do maintain internal compliance management systems in order to overcome the principal/agent problems between the board of directors and each individual employee (compliance on a "macro" and "micro" level).*

Based on the literature review it can be expected to see compliance management systems within asset management companies. Furthermore, it is clear that certain meta-regulations in the UK and in Germany exist, which require asset management companies to establish a compliance management system. What is missing in the literature, is an empirical enquiry, that illustrates how companies build and maintain actual compliance management systems.

### New Perspectives on Compliance Management Systems

The findings of the present study have enabled compliance management systems found in asset management companies to be viewed from a new perspective:
The informants labelled these systems as the "Three Lines of Defence Systems" ("TLDS") – a name that is likely linked to the risk governance system originally developed by the International Audit Institute in 2013 (IIA, 2013). There are, however, some distinct differences between the TLDS presented by the IIA and the TLDS found in asset management companies. The core difference is that the system developed by the IIA was arguably never intended to be used as a compliance management system but was rather thought of as a wider governance framework for risk management. Furthermore, the IIA has consequently, never thought of placing the Compliance Officer right in the centre of this system.
As illustrated in detail in the previous chapter, it was found that firms use the TLDS as an organisational structure that helps to bridge between the macro and the micro level in order to solve the principal/agent conflict. As a consequence, the TLDS used as a compliance management system influence the organisation of asset management companies structurally and culturally.
Structurally, the TLDS system works by allocating responsibilities from the principals to the agents. For example, the board of directors at the top of the organisation will tell their department leaders that they are responsible for ensuring that compliance breaches are avoided within their individual departments. The department leaders on the other hand will tell their sub-department leaders that they are responsible for ensuring that compliance breaches are avoided within their

individual sub-departments. Finally, the sub-department leaders will tell their individual employees that they are responsible for avoiding compliance breaches within their individual jobs. In order to ensure that potential compliance breaches are avoided on all levels, each department must develop its own internal processes and procedures, which may involve staff training, the use of desk procedures or control mechanisms such as a "four eye control" for critical processes. The department leaders are responsible for implementing appropriate internal processes and procedures for their departments and the individual employees are responsible for knowing and adhering to these processes.

The Compliance Officer plays a central role in the TLDS system, as he is responsible for ensuring that the individual business processes are at all times designed properly to avoid unlawful employee behaviour within the firm. And he is also responsible for controlling that these individual department managers really make sure that their employees are adhering to these procedures. The figure below illustrates the structure of the typical TLDS compliance management system that will be found at an asset management company. The Compliance Officer is shown in the centre and reminds the reader of a "spider sitting in the centre of a net". The red circles indicate how the Compliance Officer may need to perform controls of the individual processes and procedures implemented to ensure proper compliance behaviour. These would also be the points within a spider net that will tell the spider when a fly has landed in her net.

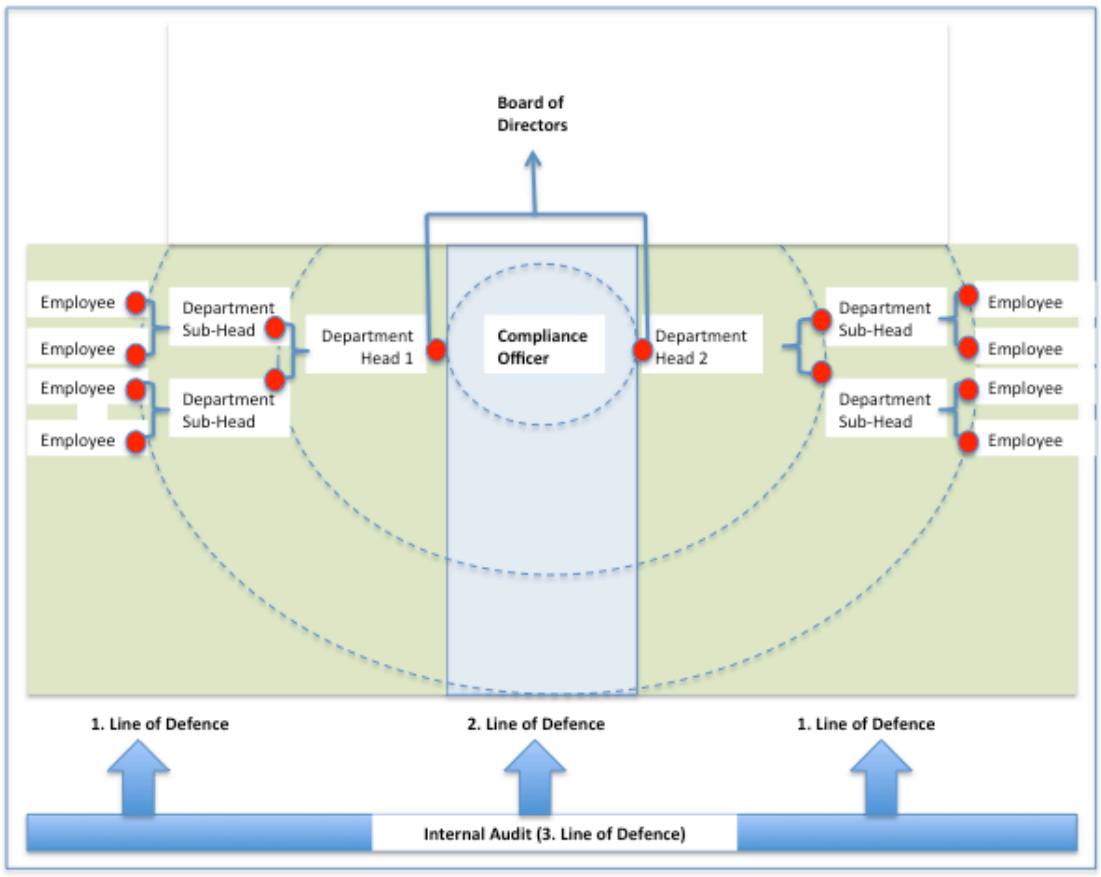


**Fig. 27***: Illustration of the Typical Structure of a TLDS Compliance Management System that will be Found in Asset Management Companies.*

Unlike these structural elements, cultural elements are unique to each individual asset management company and it would be impossible to generalise them based on the findings of the present study.

However, one clear observation was that cultural differences exist between German and UK-based asset management companies. These cultural differences relate to the perception of the regulator as an enforcement agent of the government, as outlined in detail in the data analysis and findings chapter. While all UK based asset managers thought of the FCA as a powerful authority that nobody wants to argue with, the German based companies seemed much more relaxed in their perceptions about BaFin.

### Problems of Compliance Management Systems

Additionally, the findings of the present study show two intrinsic problems that exist in reality with such a structure:

Firstly, depending on the size of the company and the number of department managers, sub-managers and employees, the number of potential control points can become too big to be managed efficiently by the Compliance Officer.
Secondly, the fact that the TLDS system is based on the downward allocation of responsibilities creates new conflicts of interests between the individual principals and agents involved.
In particular, the analysis of the informant's internal thinking indicated the existence of the following two conflicts, which will naturally influence the culture of a firm and which would not exist in non-regulated companies:

- Responsibility conflict: As the Compliance Officer has an independent oversight role and has to ensure the proper functionality of the TLDS system within the organisation, naturally many stakeholders will naturally also see him as responsible for any compliance breaches of individual employees within the firm. The Compliance Officer on the other hand believes that he should not be held responsible for compliance breaches in the firm. They see this responsibility lying with the various principals within the organisation and ultimately with the board of directors.
- Value conflict: Each individual principal within the TLDS system has to achieve certain economic goals for the company. Consequently, there is an inherent conflict between the value of achieving these economic goals and the value attributed to the role of a principal within the organisation´s TLDS system. These value conflicts exist even within the members of the board of directors. Consequently, informants think that the board of directors avoids difficult decisions and does not fully support the internal policies and the Compliance Officer as an authority (no "tone from the top").

The discovery of these two conflicts is new and valuable, as it helps to address issues with this kind of internal compliance management system. Only recently, Roussy and Rodrigue (2018) looked into the role of the internal auditor within a TLDS risk governance framework in public and semi-public organisations based in Quebec. They found that the internal auditor is often conflicted by considering himself part of the management team which leads Roussy and Rodrigue (2018) to question the proper functionality of a TLDS framework.

As explained above, the TLDS discussed in the present study is different to the TLDS risk governance framework in public and semi-public organisations, as in this context it is used as a form of compliance management system. However, a compliance management system is still a form of governance framework and the two conflicts identified in the present study relate in their core to similar problems, as the ones outlined by Roussy and Rodrigue (2018): Both of the above-mentioned conflicts have their roots in the fact that TLDS compliance management systems allocate the actual responsibility from the top to the bottom of the organisation. Individual employees are told that they will be held personally liable for any misconduct committed, while they are at the same time expected to perform a good job and to help generate profit for the company. In highly regulated business areas, such as the asset management industry, unlawful behaviour is not always the effect of wilfully performed illegal actions. Relevant laws and regulations are very complex and in reality, it can therefore not be absolutely excluded that an individual employee may simply not know or understand a specific law that he may be violating. It is therefore not completely surprising that some employees seem to believe that the ultimate responsibility for what can go wrong during their daily business should be with their employers and not with them personally.

Likewise, department managers are no legal experts either and see it as the responsibility of the Compliance Officer to ensure that all internal business processes are designed in a way that unlawful behaviour is absolutely excluded. If the Compliance Officer on the other hand then designs business processes with multiple manual control steps that have to be performed, department managers will tend to complain that such processes hinder the success of their business.

Y. Feldman and Halali (2019) argue that even "good people" are easily manipulated by subtle conflict of interest, which fall into their "moral blind spot". The two conflicts of interests laid out here are real-life examples of such subtle conflict of interest scenarios and illustrate how such conflicts can impair the functionality of the CMS.

These findings also support Bowen (2019), who argued that self-regulation (note that CMS is a form of self-regulation) suffers from the problem that it is often legitimised by pragmatic management theory and not by internalised moral values.

Ultimately, these two conflicts of interests have led to the formulation of another complementary theory:

*The effectiveness of a compliance management system will depend on potential conflicts of interests (e.g. between the board of directors and the Compliance Officer) and a firm´s ability to mitigate these.*

### Opening the Black Box of Compliance Behaviour

In summary, the findings have shown that all asset management companies face the problem that regulations have to be applied on a macro level and have to be adhered to on a micro level. Consequently, a scenario where a principal provides orders and multiple agents have to adhere to these orders exists. In order to bridge between these gaps all asset management companies have implemented an internal compliance management system referred to as the TLDS in order to overcome these principal/agent problems. It was therefore possible to theorise the following:

*Asset management companies do maintain internal compliance management systems in order to overcome the principal/agent problems between the board of directors and each individual employee (compliance on "macro" and "micro" level).*
*The effectiveness of a compliance management system will depend on potential conflict of interests (e.g. between the board of directors and the Compliance Officer) and the ability of a firm to mitigate these.*

This new theory can be seen as a substantive theory. It is valid for German and UK-based asset management companies but cannot be further generalised unconditionally.
This new theory allows expanding the process-oriented compliance model developed by Root (2018): The processes that lead to compliance behaviour are driven from an organisational level ("macro level") top down to the individuals within the company ("micro level"). This is a new aspect that helps viewing the function of compliance management systems from a fresh perspective, which hasn´t been provided by older models.
Furthermore, the present study has revealed a specific form of compliance management systems that are seen in asset management companies: TLDS. More importantly, however, the present study provides a new understanding of two inherent problems that are "built in" these TLDS:
There is on one hand side a responsibility conflict that arises for the Compliance Officer. The Compliance Officer believes that he should not be held responsible for compliance breaches in the firm, while other TLDS stakeholders may see this differently. And on the other hand, there is an inherent conflict between the value of achieving these economic goals and the value attributed to the role of a principal

within the organisation´s TLDS system. These value conflicts exist even among the members of the board of directors.

As Haugh (2017) has argued, there is a dangerous tendency among professionals within the financial services industry to rationalise unethical behaviour. If this is correct, it means that both the Compliance Officer and the members of the board could be tempted to solve such conflicts in an unethical way. For example, a board member could rationalise that company profit is more important than a properly working TLDS.

Policymakers should be aware of these issues and should change their perspective on regulating the asset management industry accordingly. The classical thinking that new regulation and more severe punishment can foster better compliance behaviour seems to be out of place. New rules or laws are only external factors that need to be internalised by the regulated companies. If a company has, however, internal problems with its compliance management system, these problems will remain in existence regardless of any new regulation or threat of punishment.

Instead of stipulating new rules for companies, policymakers would be better advised to stipulate new rules for regulators. If regulators interact more directly with the regulated companies (e.g. by performing more often regulatory audits and by keeping a closer connection with the company´s management and Compliance Officers), they will be in a much better position to detect problems in the compliance management system.

Furthermore, policymakers and regulators alike should consider the conflicts that a TLDS compliance management system can create. While these systems are efficient for regulated companies, policymakers should make up their minds whether these systems are also good from a regulatory perspective. After all, the conflicts inherent to these systems seem to increase with the size of a company and at the very least, one should consider whether there are limits to the use of such systems. Only recently Diamantis (2019) discussed which company should be punished, if a company is going through a number of corporate transformations, such as spin-offs, re-branding and name changing. In its core, this discussion addresses the same point: If companies grow very big and complex, it becomes easy for the responsible managers to hide their own wrongdoings in such a complex system and consequently, regulators should be aware of this issue.

Lastly, practitioners can also benefit from the above theory. If they have a better understanding of why a compliance management system is needed and how it can be impaired by potential conflicts, they will be able to build more robust structures and influence the corporate culture in a positive manner.

## Relevance of the Findings from Both Parts

The present study ventured to explore how regulated companies, such as asset management firms in particular, ensure that they comply with the laws relevant to their business. The more abstract research question that was addressed was how compliance behaviour actually looks within a regulated firm and how it is interlinked with the firm´s corporate culture.

This goal has been achieved, and an enhanced holistic compliance model developed, which allows a deep insight into how asset management companies ensure they remain compliant with all relevant laws. Furthermore, the present study also opened the "black box" of how compliance behaviour actually looks within these companies. The study demonstrated how the compliance management systems within asset management companies look and which problems exist with these specific structures.

Consequently, the present study has contributed to the existing literature and the on-going academic debate. Policymakers can use the enhanced holistic compliance model presented in the previous chapter in order to forecast how new laws and regulations can be effectively enforced within regulated companies. Furthermore, scholars can use the new model as a basis for further research in other areas of life, such as the compliance behaviour of non-regulated companies or companies operating in different countries and different legal systems.

Additionally, the second part offers insight and new perspectives into the compliance management systems facilitated by asset management companies. Policymakers and researchers can make use of the new perspectives in order to develop new approaches towards a more effective regulation.

Furthermore, practitioners, such as Compliance Officers can benefit from a better understanding of how compliance management systems look. The insight into potential conflicts caused by the typical TLDS compliance management system will be particularly useful for avoiding issues.

## Chapter Summary

The present chapter has outlined how the finding and hypotheses derived from the empirical research have been synthesised in order to develop new theories. These new theories are relevant, as they contribute to two different fields: The theories presented in part 1 contribute to answering questions around what drives compliance behaviour and those presented in part 2 illustrate how compliance behaviour actually functions in asset management companies.

In part 1 in particular the development of a new holistic model of compliance behaviour, which considers all motivational forces and stakeholders relevant to an asset management company, was a major contribution. This new model enhances the existing models in this area (in particularly the Nielsen-Parker Holistic Compliance Model), as it provides new and detailed information about which internal and external motivations can influence the actions of which stakeholders within and outside of an asset management company.

The second part of this chapter explained how the empirical findings have been used to develop new theory in the context of compliance behaviour. It was illustrated, how a process of constant exchange between multiple stakeholders within and outside a company influences and changes an organisation´s compliance behaviour. It confirmed that process-oriented compliance models, such as the one developed by Root (2018), could very well explain how actual compliance behaviour looks within asset management companies. However, the empirical observations made allowed the development of a new perspective for process-oriented compliance models, taking into account the differences that exist on a "macro" and "micro" level and incorporating typical principal/agent related conflicts of interests into the theoretical framework.

Lastly, "the black box" of compliance behaviour within asset management companies was opened and it was demonstrated how companies have developed specific compliance management systems, called TLDS, in order to manage compliance with all relevant regulations on a macro and micro level. In this context, it was discussed how potential conflicts of interest that are intrinsic to these compliance management systems may impair their effectiveness. This discussion offers a new perspective on effective regulation and suggests that direct interaction between regulators and regulated companies is more effective for fostering good compliance behaviour, compared with new laws and the threat of punishment.

# Chapter VII – Discussion and Development of Theory

The next chapter will reflect about the present study as a whole and about the new theories in particular.

# Chapter VIII - Reflective Commentary

*It is one thing to describe an interview with a gorgon or a griffin, a creature who does not exist. It is another thing to discover that the rhinoceros does exist and then take pleasure in the fact that he looks as if he didn´t. (Chesterton, 1908)*

Chesterton´s quote evocatively describes how reality is often more astonishing than our fantasies. In fact, real life can at times be surprisingly different to all theory. The present study has explored the reality that exists within asset management companies in Germany and in the UK in order to develop new perspectives and advanced theories about their compliance behaviour. For the researcher this was an endeavour that stretched over a period of nearly six years. Much was learned during this time about the theory of compliance behaviour and of the realities within regulated companies.

The following chapter is intended to pause, look backward and provide a reflective commentary on the research work that was done. The chapter will provide separate commentary on the literature review, the methodological approach and on the findings that were made and developed into theory.

## Commentary on the Quality of the Present Study

When providing criteria for evaluating the quality of research, Strauss and Corbin (2015) agree with Seale (2002) who once concluded that the quality of research is just like art, as it is hard to specify or explain, but we recognise it, when we see it. It is very difficult to provide a set of criteria that can be used to evaluate the quality of research. Just like art, the value of research also depends on the eye of the observer.

Therefore, the expectations for grounded theory studies will unavoidably vary and I find it difficult to provide good criteria to evaluate the quality of the present study. Charmaz (2006) has provided a list of four criteria, which she considers useful for the evaluation of grounded theory research. These four criteria are: Originality, usefulness, credibility and resonance. Given that the present study followed the ideas of Charmaz in many aspects, these criteria seem to be the most appropriate for evaluating the quality of the present study.

### 1. Originality

For Charmaz (2006) originality relates to the question of whether a research study provides new connectional rendering of data and whether it is challenges, extends or refines current ideas, concepts or practices.

The present study meets these criteria, as it aims to explore how corporate compliance actually looks in regulated firms, such as asset management firms in Germany and in the UK specifically. The study was motivated by the researcher´s disagreement with the view that more regulation or severe punishment will improve compliance behaviour. The main objective of this study was therefore to "open the black box" of compliance behaviour within asset management companies in order to show new perspectives on old theories and to develop alternative ways to improve compliance behaviour.

The study challenges and advances existing ideas and theories, which meets the definition of originality. Furthermore, this objective was fully achieved. As described in detail in the previous chapter, the present study has, on the one hand, provided new perspectives on what drives compliance behaviour within regulated companies and an enhanced holistic compliance model was developed. In addition, the present study provides a very detailed insight into how compliance behaviour actually looks in asset management companies.

## 2. Usefulness

According to Charmaz (2006) usefulness relates to the question, if the results the research can be used by other people in their everyday worlds and whether it can spark further research in other substantive areas or if it more generally contributes "to making a better world". Whether or not the present study meets these criteria should be discussed with a view of the literature review and the development of the research objectives.

A review of the personal notes of the researcher from the planning phase of the present study reveals that the research objective has actually changed through the course of the research work. Although the researcher always aimed to explore how compliance behaviour actually looks within asset management companies, in the beginning the focus was on how regulations are changing corporate culture. This ambition was driven by the idea of developing new and better ways to ensure good compliance behaviour. During the cause of the literature review the thought started to surface, that although corporate culture is linked to compliance behaviour, it would become very challenging to develop a research method that allows finding evidence showing how particular regulations have changed the corporate culture of a firm. While Kurowski (2018) has suggested good methods for designing studies that aim to measure compliance with a concrete policy, these methods would be of little use for a qualitative study that aims not only to measure, but to discover and describe, how corporate culture is changed by a specific new regulation. Even if such evidence could have been found, it seems likely that these findings would be closely connected to the culture of one specific company and would be very difficult to generalise.

For that reason and with a better knowledge of the existing theories, the research objective was later changed: The new objective was still to explore compliance behaviour within asset management companies, but with the focus on enhancing existing theories and providing new insights and new perspectives into this research area. This research objective seemed more promising, as it was concluded that existing compliance theories are too narrow and have so far not helped to develop any good practical guidelines that really help to improve compliance behaviour in the financial services industry in order to avoid financial crises.

Judging by today, it could be said that the researcher´s core interest of exploring how compliance behaviour looks in reality and providing new and alternative perspectives

on how good compliance behaviour can be enhanced, has not changed. However, the review of the literature and a better understanding of existing theories in the field have helped to frame a better and more relevant research objective. The criteria for a useful study were thereby achieved.

## 3. Credibility

According to Charmaz (2006) credibility relates to the question of whether sufficient empirical evidence have been provided in order to cover a wide range of categories and observations and to provide enough evidence for the claims made. I will use a few reflections to demonstrate, why these criteria have been achieved:

### *Reflection about the Interviews*

In the present study, in-depth interviews with very experienced industry experts yielded the empirical basis for analysis and for the construction of theory. While it must be admitted that the number of interviews (13 interviews) is relatively small compared to other studies based on interview data, these 13 interviews yielded high-quality data, which were sufficient to explore a wide range of categories and empirical observations. This is mainly due to the fact that these senior experts all had long-standing experience in the subject of the enquiry and were therefore able to provide insights into the area of corporate compliance, which could not have provided by any junior industry experts with only a few years of experience. Consequently, even if the total number of interviews was small, the accounts provided during these interviews represent many years of experience. For example, if a senior industry expert has 15 years of work experience, the accounts he provides during an interview, would be at least equivalent to interviews with three junior experts who each have just five years of relevant experience. If we consider the quality of the interview data collected in these 13 senior expert interviews in this manner, the argument could be made that they represent the same empirical value as 39 interviews with junior experts that have only five years of relevant working experience.

Furthermore, only senior experts with more than 15 years of relevant experience are able to provide empirical accounts that illustrate a wide range of topics and also show how certain observations have changed over time. Therefore, while it would have been easily possible to conduct 40 or more interviews with junior experts, it

was consciously decided that only senior experts should be interviewed for the present study. For this reason, the fact that only senior experts have been interviewed therefore enhance the credibility of the present study, even though the number of these interviews was relatively limited.

### *Reflection about the Choice of Methodology*

Nonetheless, it must be admitted that conducting in-depth interviews with members of the compliance elite of German and UK-based asset management companies was another challenge. As discussed in more detail in the methodology chapter, the grounded theory method would typically require entering the field with an open mind and consequently performing interviews in a completely open manner and without any pre-defined interview guide. The observation made in the present study was, however, that interview participants turned out to be very demanding and requested to see at least a high-level guide about the topic of discussion before agreeing to participate in an interview.

In order to avoid the risk of losing access to the relevant industry experts, it was decided to make a compromise and develop a high-level interview guide, though the interviews would still be held in a very open and explorative manner. In this way, it was possible to remain open minded, while still comforting the interview participants.

Gaining access to relevant compliance experts was a constant challenge throughout the empirical work.

This raises the question of whether other methods could have been better for the purpose of the present study. Some compliance researchers have used questionnaires instead of interviews in order to get access to a much wider group of participants. For example, Elffers, Van Der Heijden, and Hezemans (2003) used the "Table of 11" developed by Ruimschotel (2004) as a basis for a survey study of rule transgression in the Netherlands. Perhaps, it would have been easier to gain access to relevant experts, if they did not need to attend lengthy interviews, but could simply have been asked to complete a questionnaire.

However, using questionnaires requires pre-defining questions, which is difficult, if the researcher aims to explore a field and develop new perspectives. Conducting in-depth interviews was therefore ultimately considered to be more appropriate. Nonetheless, the findings and theories presented in the present study will provide a good starting point for future research using questionnaires. Such research could be

particularly useful in order to test whether the theories presented herein are also generalisable into other industries or countries.

Following the research method proposed by Yin (2014) and doing a case study on just one single company would have been another possibility. This would have been equally explorative and would have allowed developing new perspectives. The problem with such a case study is, however, that it would be focussed on just one single company. The result would consequently reveal a deep insight into the compliance behaviour of one company.

Given that companies fear that someone could put a negative light on their internal compliance culture and as it was already challenging to gain access to compliance professionals under the condition that they would not disclose the company they work for, it seems practically impossible to find a company that would be willing to participate in such a case study.

### *Reflection about the Exchange of Thought*

As explained in detail in the chapter about methodology, conducting interviews and analysing the results was a constant and alternating process. This process helped to inform later interviews and to understand better, when a lead topic or concept were theoretically saturated. However, it must be admitted that this process was very challenging for a novice researcher. There exist multiple different coding strategies that can be used for grounded theory research. All strategies provide a different angle on the data. For example, line-by-line coding will lead to different discoveries in the interview text, than axial coding. The present research project has facilitated various different coding strategies and has even re-coded the same interview text multiple times. This was of course not an efficient process. In fact, analysing and truly understanding the data took much time and effort. Only the presentation of intermediary findings and immature theories at two different academic conferences (at the 12$^{th}$ CIRCLE conference in 2015 and at the 9$^{th}$ EMAB conference in 2016) finally helped to develop a satisfactory data analysis upon which new grounded theories could be developed. Thinking back, it seems therefore that the exchange with other researchers is a very useful part of the data analysis and should have been planned much more stringently from the very beginning.

### *Reflection on the Explorative Aspect of this Study*

Furthermore, the focus on exploring compliance behaviour in order to develop new perspectives helped to develop an appropriate research methodology.
Conducting in-depth interviews with elite members of the compliance profession within the asset management industry was a good way to start such an exploration, particularly because no other compliance researcher had ever done this before.
Reflecting on the interview phase it must, however, be admitted that it was underestimated how difficult it would be in reality to gain access to members of this elite. Although, the researcher works in this profession and therefore has a better access to these people compared with others, it was a long and difficult journey to find enough interview participants.
Grounded theory method guided the open and explorative nature of the interviews, as well, as the development of new perspectives.
However, it should not be omitted to mention that this method also caused some issues for the research work: The biggest issue was that the open and explorative nature of this method produced empirical data relating to different theoretical fields. As shown in the previous chapter, the findings have contributed to the development of new theories about what triggers compliance behaviour in part 1 and how compliance behaviour actually looks, in part 2. While this was a likely outcome of the open interviews that were used as a basis, it was actually very inefficient. As explained in more detail in the literature review chapter, a compliance researcher will usually choose to either treat compliance behaviour as endogenous to their research (i.e. if they want to study what it looks like) or as exogenous (i.e. if they want to study what influences the behaviour). Conducting research work, which does not give a clear direction in this regard will naturally cause a lot of issues. In the present study these issues were dealt with, as the findings of theories relating to both areas were presented in two separate parts.
Nonetheless, research work would have arguably been easier and analysis at times more stringent, if only one standpoint would have been taken. For example, the interviews could have focussed on the question of what triggers good or bad compliance behaviour, or on how such behaviour actually looks. However, while a narrower focus would have made things easier, it would have limited the insights that could have been gained on both sides. Seeing how compliance behaviour actually looks and what motivates it has helped to develop a better understanding of the

different issues that exist for companies on a macro- and micro level. For example, if the fact that companies build up internal compliance management systems in order to deal with internal principal agent issues had been ignored, it would probably not have been identified that, while normative motivations play a great role in fostering compliance behaviour among the employees within a company – they are much less relevant for the organisations overall compliance behaviour on a macro level.

## 4. Resonance

Resonance for Charmaz (2006) relates strongly to the question of whether the discovered grounded theory makes sense to the actual participants or people who share their circumstances. It is difficult to speculate whether this is the case. Consequently, it was decided to present the results of the present study to two of the original participants to test their resonance. Informants 12 and 13 were selected to participate in this form of "resonance testing". Informant 12 was from the UK and informant 13 from Germany. Both were female and both have more than 15 years of practical industry experience.

Presented with the new models and the emerging grounded theories as outlined in the previous chapter, both informants made similar comments. Both agreed that these models would largely work for forecasting compliance behaviour in their respective organisations. Particularly, having a good awareness about the importance of normative compliance motivations within the company and a good understanding of the inherent conflicts existing within the TLDS will be very useful for any compliance professional.

As an interesting side note both made the comment that the findings of this study would make them think about compliance behaviour within companies as a form of "corporate conscience". They explained that seeing the functionality of a compliance management system, as laid out in the present study brought to mind a structure that filters ethical behaviour and would therefore resemble the functionality of similar mechanisms within individual human beings. Human beings also need to build a conscience, by learning what is good and what is bad. And just as companies have a Compliance Officer, humans have their own "inner voice", which judges their actions against their internal ethical standards. Some researchers have already discussed the possibility of companies developing their own corporate conscience (e.g. S. P. Feldman (2004), Goodpaster and Matthews (1982)), but the findings

presented in the present study could be used as a starting point to explore this interesting question from a new angle.

Lastly, the presentation of the intermediate findings of the present study at three conferences (as outlined above) also served to confirm the relevance of the study in the field of academic research.

## Limitations of the Present Study

Although the research objective has been achieved, the grounded theories presented have of course some limitations, which should be discussed here:

The theories developed are only substantive theories. This means that they have been developed with a view of asset management companies in Germany and the UK and strictly speaking they are only valid in this context.

Firstly, this means that the findings and theories can only speak for companies in the asset management industry. It is, however, likely that other regulated companies, such as banks, would have provided very similar results, if a comparable study had been performed. Arguably, the findings and theories presented in the present study can thus be generalised for a variety of other regulated companies.

Secondly, the findings and theories presented are limited to companies based in Germany and the UK. It must also be acknowledged that the German informants of the present study were far more numerous, then the British informants (see table 5 in chapter V for more details). Therefore, the results of the present study are clearly more applicable for German and less for UK based companies. Nevertheless, it is likely that asset management companies located in countries with similar cultural, political and legal environments would produce similar findings and allow the development of the same theories, if a comparable study were to be conducted. Given the close proximity of the cultural, political and legal environment for all countries within the European Union, the findings and theories presented can arguably be generalised to these countries, but not any further.

Another limitation in respect of the data used for the present study must be seen in the fact that the names of the informants and of the actual companies for which the informants are working cannot be disclosed. As explained in more detail in the section “Ethical Considerations” in chapter III, this was necessary in order to protect the privacy of the informants. Although, the researcher aimed to include informants from the largest asset management companies in Germany and the UK, it must be admitted that the fact that these companies are not disclosed will limit the reproducibility of the study.

Lastly, it seems likely that the findings and theories presented are also limited to the period of time, to which they relate. That means that if someone were to conduct the same study in 10 years from now, he might end up with different findings and theories. The reason for this is the fact that both asset management companies and

respective regulation are very dynamic. There is a multitude of new regulation developed every year and at the same time asset management companies are evolving, as they, for example, begin to use more modern technology and reduce their manpower. Without a doubt, these developments will have strong influences over what motivates good compliance behaviour and on how good compliance behaviour will actually look in the future.

## Chapter Summary

The present chapter offered a reflective commentary on the methodology used, as well as on the actual interviews and on the findings and theories that were developed. The chapter demonstrated that, while the quality of research is difficult to measure, the present study will at least fulfil the four core elements offered by Charmaz: Originality, usefulness, credibility and resonance.

It demonstrated that the study can be considered original, as it offers new perspectives on how compliance behaviour actually looks and as it advances existing theories in the area of what motivates compliance behaviour.

The study was also useful, as it can certainly spark further research in other substantive areas. Also, the credibility of the present study was discussed in detail. It explained that the present study was based on only 13 in-depth interviews; the quality of these interviews was so high that this was sufficient. Furthermore, it also showed that other research methods, such as using questionnaires or case studies could not be expected to yield the desired results. Consequently, it was argued that conducting a limited number of in-depth interviews with senior experts and using grounded theory method to guide the data analysis and the development of theory and new perspectives was in fact an appropriate and credible way to achieve the research goals.

Lastly, the limitations of the present study were discussed and areas for future research were suggested.

The following chapter will conclude the present study.

# Chapter IX - Conclusion

*The imperfection of Geolog. Record is, as you say, the weakest of all; but yet I am pleased to find that there are almost more Geological converts than of pursuers of other branches of natural science. (Darwin, 1860)*

Writing to his friend, Alfred Russel Wallace, Darwin admitted that the biggest weakness in his evolutionary theory was in fact the imperfection of geological records. Incomplete empirical evidence (i.e. missing links in the fossil record) made it hard for Darwin to defend the correctness of his theory. Ironically, he noted to his friend that among all scientists criticising his new evolutionary theory, only the geologists seemed to be of the least concern for this weakness.

Although the present study does not rely on any fossil records, the difficulty in getting access into how companies organise their compliance departments and how they react to new laws and regulation made it equally difficult to obtain empirical evidence in the field of corporate compliance. Still, little is known about how corporate compliance actually looks and how regulated companies build internal mechanisms in order to comply with all relevant laws and regulations.

However, using asset management companies in the UK and in Germany as an example, the present study makes an important contribution to the endeavour of "opening the black box" of compliance behaviour in regulated companies.

The present study was not guided by a detailed research question derived from the literature review. Nor did the present study test any pre-existing theory. Instead, the present study should be understood as an "exploration" of the field of corporate compliance. It can be described as a type of "constructivist grounded theory method" that was used in order to explore how compliance behaviour looks and how it is motivated.

The analysis of 13 in-depth interviews with elite members of the compliance profession yielded new insights in both areas, (1) what motivates compliance behaviour and (2) how compliance behaviour actually looks in regulated companies.

## Conclusions about Motivations for Compliance Behaviour

The study contributes to a better understanding of which factors motivate compliance behaviour within a company. In particular, it should be highlighted that the older Nielsen-Parker Holistic Compliance Model simply explains that economic, social and normative forces will all have some impact on the organisational capacities and characteristics of a company. The new Holistic Model of Motivational Forces presented in the present study (see fig. 26) provides a much more refined understanding about how these forces are actually at work within asset management companies in Germany and in the UK. Thereby the new model allows the following advancements in the understanding of compliance behaviour:

1. It shows which stakeholders are mainly influenced by economic, social or normative forces;
2. It shows that economic and social motives are mainly driven by external forces, while normative motivations are driven by internal forces and;
3. It illustrates how various stakeholders within and outside of a company context can have direct and indirect influence on its compliance behaviour.

While it must be acknowledged, that the majority of informants were from Germany and not from the UK, the new Holistic Model of Motivational Forces can still be used by policymakers in both countries to effectively develop methods to enhance compliance behaviour in the asset management industry.
Policymakers should consider the important role of normative motivations as internal forces for compliance behaviour. They should further strengthen the importance of normative motivations within firms, by strengthening the role of an internal Compliance Officer as a transmitter of normative motivations. Regulators could even think of monitoring how firms provide normative compliance motivations internally. The fact that certain stakeholders, such as the board of directors act as a link to bridge between external and internal compliance forces is also of relevance. Policymakers should develop methods to monitor more closely, how stakeholders in such a position fulfil this role. For example, some larger companies tend to develop a complex legal structure with multiple holding companies between the board of directors and the actual operative entities. Policymakers could ask whether this could cause situations in which a board of directors has become so remote from the actual

operative business that it loses the power (or the interest) to set the right internal compliance motivations.
Lastly, rather than imposing draconic fines on companies, which will ultimately be paid by the shareholders, policymakers should consider increasing the personal liability of the board of directors for any failures of the internal compliance behaviour on a micro level.

### Conclusions about How Compliance Behaviour Looks

Furthermore, the present study also helps to advance our understanding of how compliance behaviour actually looks in regulated companies. It illustrated in great detail the typical compliance behaviours seen in asset management companies. It showed that all asset management companies face the problem that regulations must be applied on a macro level and have to be adhered to on a micro level.
Consequently, a scenario where a principal (the board or the Compliance Officer) provides orders and multiple agents (department leaders and individual employees) have to adhere to these orders, can be observed in these companies.
In order to bridge between these gaps all asset management companies have implemented an internal compliance management system referred to as the TLDS in order to overcome the principal/agent problems. It was therefore possible to theorise the following hypotheses:

*Asset management companies do maintain internal compliance management systems in order to overcome the principal/agent problems between the board of directors and each individual employee (compliance on "macro" and "micro" level).*
*The effectiveness of a compliance management system will depend on potential conflict of interests (e.g. between the board of directors and the Compliance Officer) and the firm´s ability to mitigate these.*

Epistemologically, this new theory must be described as a substantive theory. That means, it is applicable for German and UK based asset management companies but cannot unconditionally be further generalised.
This new theory allows the process-oriented compliance model developed by Root (2018) to be seen in a new perspective: The processes that lead to compliance behaviour are driven from an organisational level ("macro level") top down to the individuals within the company ("micro level").

Furthermore, the present study illustrates in detail the special type of compliance management systems found in asset management companies. These compliance management systems are likely to be inspired by a corporate governance framework for risk management, presented by the IIA (2013), and labelled the "three lines of defence systems" or "TLDS". The functionality of these TLDS, to manage specific principal/agent related problems in the setting of asset management companies, was illustrated in great detail. Most importantly, the study provides a new understanding of two inherent problems that are "built in" these TLDS:

Firstly, these systems are prone to an inherent responsibility conflict that arises for the Compliance Officer: The Compliance Officer believes that he should not be held responsible for compliance breaches in the firm, while other TLDS stakeholders may see this exactly the other way around.

Secondly, these systems are vulnerable to an inherent conflict between the value of achieving economic goals and the value attributed to the role of a principal within the organisation´s TLDS system. As Haugh (2017) has argued, there is a dangerous tendency among professionals within the financial services industry to rationalise unethical behaviour. If this is correct, it means that both, the Compliance Officer and the members of the board could be tempted to solve such conflicts in an unethical way. For example, a board member could rationalise that company profit is more important than a properly working TLDS.

It is important for Compliance Officers and board members to be aware of these conflicts in order to maintain effective compliance systems in their organizations. Also, policymakers should be aware of these potential conflicts and should change their perspective on regulating the asset management industry accordingly. The classical thinking that new regulation and more severe punishment can foster better compliance behaviour does not work. New rules or laws are only external factors that need to be internalised by the regulated companies. If a company has however internal problems with its compliance management system, these problems will remain in existence regardless of any new regulation or threat of punishment.

## Closing Thought

Ultimately, the results of the present study lead me to argue that instead of stipulating new rules for companies, policymakers would be better advised to stipulate new rules for regulators. If regulators interact more directly with the regulated companies (e.g. by performing more frequent regulatory audits and by

keeping a closer connection with the company´s management and Compliance Officers), they will be in a much better position to detect problems in the compliance management system or elsewhere within these companies.

# Glossary

| | |
|---|---|
| AIFM | Alternative Investment Fund Managers Directive 2011/61/EU |
| Asset management | The active management of assets in order to optimize return on investment. |
| Asset management company | A company with a special license obtained by a regulator and with the business objective to manage assets in order to optimize returns. |
| Asset management industry | The part of an economy in which asset management companies operate their business. |
| CMS | Compliance management system |
| Dodd-Frank Act | Dodd–Frank Wall Street Reform and Consumer Protection Act (Pub. L. 111–203, H.R. 4173, commonly referred to as Dodd–Frank) |
| GTM | Grounded Theory Method – A method for conducting qualitative research that focuses on building theory through inductive data analysis. |
| Investment company | See “Asset management company” |
| MiFID | Markets in Financial Instruments Directive 2004/39/EC |
| Regulation | Regulation means a set of rules codified in a law. |

## Glossary

| | |
|---|---|
| UCITS | Undertakings for Collective Investment in Transferable Securities Directive 2009/65/EC |
| US sub-prime crises | The US banking crises of 2007 to 2010 caused by the massive defaulting of mortgage loans. |
| TLDS | Three Lines of Defence Compliance Management System |
| Whale Fall | The dead carcase of a whale sunk to the ground of the sea. |

# Appendix

## Appendix 1 – Interview Guide

***Topic 1:***

***"How is national and international law implemented in compliance related functions of regulated companies in the case of a German asset management company?"***

**Q1:** What do you think motivates a company to ensure proper compliance (e.g. moral values or fear of sanctions)?
**Q2:** What is your view/ experience of how companies ensure that all relevant laws are complied with? (Please provide examples from your personal experience)
**Q3:** Who (or which department) ensures that new regulations are understood and followed? (Please provide examples from your personal experience)
**Q4:** How does interaction between these persons (or departments) and other departments and external stakeholders such as auditors or regulators typically work? (Please provide examples from your personal experience)

**Topic 2:**

***"Does "compliance behaviour" change an organisation's corporate culture at personal and organisational level and if so, how can these changes be conceptualized?"***

**Q5:** How would you describe good compliance culture?
**Q6:** What changes compliance culture to positive or negative (Please provide practical examples)?
**Q7:** Do you think regulation is changing compliance culture (Please provide practical examples)?

## Appendix 2 - Declaration of Consent

Background and overview of the research project:

The purpose of this interview is to provide empirical data that will be used for a research project performed by Christian Zwerenz in the context of a doctorate program at the University of Gloucestershire. The aim of this research project is to gain a deeper understanding about what compliance behaviour looks in real organisations. The two main research questions are:

1. *How is national and international law implemented in compliance related functions of regulated companies in the case of a German asset management company?*
2. *Does "compliance behaviour" change an organisation´s corporate culture at personal and organisational level and if so, how can these changes be conceptualized?*

Data Usage and Data Privacy:

The researcher would like to ensure all participants that no names, neither of the persons being interviewed, nor of the companies they are working for, will be made public. All information obtained during the interview will only be used in an anonymous manner (acronyms like "informant 1" will be used instead of names of person or companies). The researcher has the right to use interview information for his research work and may publish sections or complete interviews (the interviewer and his company will not be named).

The researcher also assumes that all statements made by the interviewee reflect their own personal views and are in no way official statements made on behalf of the company for which the interviewee is currently employed.

Ethical standards:

Please note that it is not intended to obtain any information about potentially illegal activities in the course of the interview.

Recording:

In order to focus on exchanging different views and leading a discussion it is intended to record this interview for later transcription. All voice recordings will be

kept strictly private and confidential and will be destroyed 3 months after the research project has been completed (anonymous transcripts of the interview may be kept longer).
Please tick the box below to indicate whether you agree to this interview being recorded.

Yes ☐ No ☐

Declaration of Consent:
I hereby confirm that I have been made aware of the background and the purpose of this interview and I agree that the information obtained during this interview may be used as intended.

_____ _____

Date Name

## Appendix 3 – Codes and Categories Developed After Phase 1 and Phase 2

| **Thematic Categories** | **Incidents ("Codes")** |
|---|---|
| Future of Compliance | Improve monitoring by better technology |
| | Innovative Compliance training |
| | Emphasize on advisory role |
| | Focus on moral values |
| Compliance Changes Corporate Culture | Law is transformed to internal policies |
| | Expectation that internal rules are respected beyond the law |
| | The role of regulation |
| What Changes Compliance Culture in a Firm | Compliance training |
| | Punishment is not motivating |
| | Tone from the top |
| | New regulation |
| What Changes Compliance Culture in an Industry | Best practise |
| | Discussions between firms |
| | Guidance by industry associations |
| | Industry lobbying |
| | Regulators set new standards |
| | Self-regulation in the industry |
| What is Compliance Culture | Internal procedures |
| | Department managers |
| | Embedding law into internal policies |
| | Everyone takes responsibility |
| Compliance Organisations | Compliance organisations |
| Compliance Projects | Compliance projects |
| Features of a Compliance System | Compliance has special rights |
| | Compliance is independent |
| | Compliance Officer is personally liable |
| | Role of Compliance Officer |
| | Three lines of defence |
| How Firms Learn About New Regulation | How firms learn about new regulation |
| Implementing International Regulation | Implementing international regulation |
| Interaction with Stakeholders | Compliance vs. supervisory board |
| | Conflicts between Compliance and Management |
| | Compliance vs. regulator |
| Motivations for Compliance Behaviour | Fear of losing assets and clients |

Appendix

| | |
|---|---|
| | Fear of losing license |
| | Fear of negative reputation (various) |
| | Fear of personal liability |
| | Fear to be sanctioned (e.g. to pay a fine) |
| | Group pressure and best practise |
| | Moral values are not important |
| | Strong Compliance as selling argument |
| Roles of Different Stakeholders | Consultants (various) |
| | External auditors (various) |
| | Industry associations (various) |
| | Senior Management |
| | Company´s shareholders |
| | Compliance department |
| | Legal department |
| | Regulators |
| | Risk Management department |
| Economic Compliance Motivation | Examples of deterrence |
| | Limitation of deterrence effect |
| Normative Compliance | Examples of normative Compliance |
| | Increased normative Compliance in certain situations |
| | Self-regulation |
| | Value perceptions |
| Social Compliance | Client pressure |
| | Group pressure |
| | Informal networks |
| | Limitations |
| Historical Development of the Compliance Profession | Historical development of the Compliance profession |

## Appendix 4 – Table of Codes "Internal Thinking" - Compliance Motivations

| Codes | Sub-Category | Category | Internal thinking |
|---|---|---|---|
| _fear of receiving financial fine from regulators is seen as important motive (but less important than reputation)<br>_fear of losing license is seen as very basic economic motivation<br>_fear of being personally sanctioned by a regulator is seen as strong motivation | Fear of financial impact of a sanction | Economic motive | Informants think that the fear of losing the ability to do business motivates the firm to make sure to be compliant with all relevant laws ("macro level") |
| _thinks that public sanctions from regulators damage reputation towards clients<br>_thinks that firms fear most strongly about reputation towards clients during difficult market situations<br>_thinks that firms fear losing reputation towards clients<br>_thinks that firms fear loss of reputation<br>_thinks that fear of losing clients due to reputational damage is more relevant for smaller firms | Fear of reputational impact of a sanction | Economic motive | Informants think that companies fear being sanctioned for weak compliance controls, as this will cause a reputational damage and impair the ability to win or retain clients ("macro level"). |
| _the fear of being detected for wrong doings varies for different processes<br>_auditors are seen as agent to the regulators<br>_auditors are seen as being conflicted (being independent and earning money) | Fear of being detected and punished | Economic motive | Informants think that external auditors act as agents of the regulator and fear that they could report weak compliance controls, which could lead to financial sanction or reputational damage ("macro level") |
| _Peer pressure<br>_Knowledge exchange in informal networks<br>_self-regulation in the industry<br>_industry lobbying | Social ("peer") pressure | Social motive | Informants think that companies fear to be discovered in having less advanced systems and controls to ensure compliant |

| | | | |
|---|---|---|---|
| _Guidance by industry associations | | | behaviour than most other peers have ("macro level") |
| _development of internal values<br>_thinks that employees should be motivated to follow the firm´s values intrinsically<br>_Normative and economic values are in conflict with economic interests<br>_internal values are developed and reflected by senior management<br>_firms internal policies reflect moral values<br>_firms internal policies go beyond legal requirements<br>_thinks that employees are afraid of punishment | Fear of internal sanctions | Normative motive | Informants think that all employees and department leaders fear personal consequences, if they fail to meet the firm´s internal policies/1. line of defence ("micro level") |

## Appendix 5 – Table of Codes "Internal Thinking" - Compliance Behaviour

| Codes | Sub-Category | Category | Internal thinking |
|---|---|---|---|
| _fear of being held personally responsible for a compliance breach within the firm<br>_responsibility (for Compliance) is seen with the department managers<br>_responsibility (for Compliance) is seen with Board of Directors<br>_responsibility (for Compliance) is not seen with the Compliance Officer | Defining the scope of responsibility for the Compliance Officer and others | Responsibility conflict | Informant thinks that the responsibility for individual Compliance violations should ultimately be either with the board or with the relevant department manager, but bot with the Compliance Officer. |
| _Shareholders can hold the CEO responsible for Compliance breaches<br>_thinks that the UK regulator holds the board liable for violations | Conflicting responsibilities / values | Value conflict | Informant thinks that the board of directors has to serve the shareholders and the Compliance Officer has to serve the regulator. |

## Appendix 6 – Stakeholders Influencing Compliance Behaviour Within a Company

| Stakeholder | Internal/External | Direct/Indirect | How? |
|---|---|---|---|
| **Compliance Officer** | Internal | Direct/Indirect | Establishes Compliance culture ("procedural justice") / Leads regulatory change project and oversees the Compliance Management System |
| **Board of Directors** | Internal | Direct/Indirect | Decides about resources used for the Compliance Management System / Gives authority to the Compliance Officer ("tone from the top") |
| **Department Managers** | Internal | Direct/Indirect | Enforces and monitors compliance behaviour of individual employees / Provides example for acceptable behaviour. |
| **Legal Counsel** | Internal | Direct | Supports interpretation of laws and regulations |
| **Risk Management** | Internal | Direct | Supports the decision making about resource planning for Compliance Management System |
| **Consultants** | External | Indirect | Supports interpretation of laws and helps during projects. |

| Stakeholder | Internal/External | Direct/Indirect | How? |
|---|---|---|---|
| **Industry Association** | External | Indirect | Provides a platform for exchange of knowledge and acts as single point of contact to Regulators. |
| **Regulators** | External | Direct/Indirect | Can enforce sanctions in case of misconduct / Publications have a signalling effect. |
| **Auditors** | External | Indirect | Act as “eyes and ears” of the Regulators |
| **Clients** | External | Indirect | Incentivise good Compliance behaviour but withdraw money in case of misconduct. |
| **Competitors** | External | Indirect | Can set a new benchmark for new business practises and controls. |

## Appendix 7 – Example of Interview Transcript

Interview 3

Date: 15.03.2016

Role of informant: European Head of Compliance (30 year + experience)

Education: Business Administration & Accounting

Company: Asset Management

Country: Germany + UK (multinational company)

I: Informant

R: Researcher

*R: Thank you for attending this. Can you please tell me how much experience you have in compliance?*

*I: Over 30 years. It is perhaps also worth mentioning that I belong to the first batch of officially registered Compliance Officers in the UK in 1988. At this time a new act required for the first time firms to have Compliance Officers – so it is a defined term with defined responsibilities – At the time the regulators have an approach to approve – SROs – Self Regulated Bodies – and one of the requirements was that the firm must have a Compliance Officer – At the same time they also have a regime for authorizing Compliance Officers – So I became member of the first batch of authorized Compliance Officers in the UK.*

*R: So that means you started your career as a Compliance Officer in the UK?*

*I: No – I had actually a career change – so before that I was working as a public accountant – chartered accountant – I got six years of auditing experience – and a couple more years in a bank in an accounting role and then I moved into compliance – In compliance I worked for the sell-side as well as for the buy-side – sell-side experience meaning working for a broker dealer – so I worked for a marked maker in euro bonds – and also a research firm covering all aspects of equities – so those are the sell-side experiences – and other then that it's all buy-side – which is asset management experience.*

*R: Great – so thank you very much! Let's jump into the topic. I am interested how firms really live compliance – how they organize their compliance departments – and also the cultural aspects involved – I prepared a few questions to streamline the discussion – but this should be a open discussion – more like a conversation – So one thing that I am interested in is your view on how companies ensure to comply with all relevant national and international regulations? How do they learn about new laws? How do implement changes, etc.?*

*I: Generally, the way compliance is understood by the firm – is that compliance is a department that ensures that the firm is compliant with the laws and regulations. So it is an expectation by the management that somebody else is responsible – but, as we know that at least in the last five years – five years because Europe has more or less caught up – but in other jurisdictions, such as in the USA and the UK in particular – the regulators have already come up with an understanding that the people at the top – the senior management – must own the responsibility for compliance – and they then have to hire somebody to do the compliance-work for them – while they still remain responsible for the function!*
*So that is the big cultural change that has taken place over the last five years in Europe – probably 10 years in the UK and even longer in the USA – so who is responsible for compliance of the company? That is the management of the company – "the management of the company" – that has boiled down to the CEO – at least in the UK – so the highest ranking person that is responsible for the company is also responsible for compliance – so in the cases where a firm has failed with compliance – when a firm had breaches and had received fines – quite often you find that the CEO is also the person in the "firing line" – and although there are not many examples from big firms, there are smaller firms where the CEO personally has been fined for violations – mostly in the UK – I haven´t seen it elsewhere. But the consequence of this is that the company than may make the CEO the responsible person and therefore he has to step down.*
*This is not a kind of immediate reaction – but ultimately that can happen and there are many examples of CEOs who have left firms because of severe regulatory violations – in big banks for example and at asset managers, too.*

*R: That is very interesting. So, the responsibility rests of course with the senior management – with the CEO in the case of the UK. Also, in Germany often the CEO owns this responsibility – isn´t it?*

*I: You have to nominate somebody – normally in boards – the board is divided into different functional divisions in the hands of the people that sit in the board – so a board member can have several responsibilities, compliance being one of them. But ultimately a board member is the highest representative of a firm – and ultimately the responsibility lies in the hands of one responsible person in the board – and that responsible person than can be the CEO. In other cases, it can also be a director – in XXXX´s board for example the person responsible for compliance is Ms. XXXX – she is actually the Head of the Mergers & Acquisition department – so she is not the CEO. In any case somebody has to be appointed and officially documented that he has the responsibility.*

*R: Alright. And then from there the person having the responsibility hires a Compliance Officer - or if this a big firm – they hire someone like you, who will than build up a complete compliance organisation …*

*I: Well – the board as a whole – even under German law – is responsible to ensure that compliance is given the right resources – and has the right level of competence to perform this role. So, the board has the job to consider: "Who do I find that is competent enough to do this job?" The first task is the recruitment role – the second task is – now that I have recruited a person – to ask myself, do I have sufficient resources to perform the compliance functions? So, for example significant compliance changes must be approved by the supervisory board – that means, if one person goes it is probably not an issue, but, I think if you have a need to reduce the compliance resources by a certain percentage – I don´t know – let´s say by 50 per cent – then you really need to get the supervisory boards approval. You could not just simply on XXXX level say let´s "down-size" by 50%.*

*R: That is interesting – so the compliance department has a standing that is different from other departments – for example the legal department does not necessarily have the same type of protection. Can you elaborate on this?*

*I: Well I mean the word "regulation" in people´s mind immediately means "law". Law must be in the hands of lawyers, because they are the only competent people that can read and interpret the law – which is kind of true – I mean laws are written in a way that it has to be interpreted – it is never quite prescriptive enough for you to follow it step by step – there is a specific amount of case law behind what this particular law means – and I think that is something where the legal colleagues have a better angle in getting the right answers. So – I would say, that regulation as it is written today has two elements: One is a kind of policy type of wording, where you can make a broad interpretation and another one that is sometimes very prescriptive – which means that you have to follow it word by word without any chance for interpretation. That are two different levels, but ultimately – who is that one department or person that is actually understanding this? – This is the legal department. – Because this is written for lawyers – somebody has to understand this – what does this mean in the context of what we do? I think that "bridge" is best handled by the lawyers. It can also be handled by people who are experienced compliance people – compliance is about bringing that law into life. How do you bring a particular requirement into life? And that is not explained in the law – so just take the example of best execution – where the requirement is to achieve the best possible result given a set of potential outcomes – how does that work? You can say there are probably 10 different parameters, but there are all not the main one at any point in time – collectively they can be – but even just one or two can also be the determinant over that particular transaction.*

*So, compliance has the job to find a solution. How do you translate that one requirement into a process? How many steps do you need to take to be able to demonstrate and document why you do, what you do – and then once you do that – how do you bring all of that into a process? - Into "what people do on a daily basis"? That´s what I mean by embedding law into the daily processes. Before I buy this security I have to check the screens to get the best price – than I can document that e.g. in Bloomberg – and then that becomes my record – this is where compliance comes in – it is step by step – if you do this than I can show you this – that can be documented and saved and checked afterwards – then the compliance role is to say: "I come back every so often – once a month – or, if it is more risky, I come every day, but I will check what you do." Compliance should not do the process itself.*

*Legal and risk management are two complimentary functions – where risk management comes in is… – Risk has a kind of a mandate managing the companies risk appetite. This is never quite defined in a way that is by regulation – but regulation has tried to define different types of risks – and is expecting different reports. For example you are looking at "what is credit risk?" – and then credit risk can be sub-divided into "how do you check it" – for example leverage, derivatives, etc. – and then you can define a formula for this (how do you check it) – Risk has now a function in a firm that is more operational – when you run a company than what are the risks, from business continuity to financial loss, etc. – this are operational errors –*

*Then you have this kind of more precise "investment type risk" – i.e. making investment decisions within the risk tolerance of the client. There is liquidity risk, credit risk, market risk – there are different things that can influence investment decisions. These can also be described as either investment objective or it could be a risk appetite that you have. Risk is therefore responsible to look into investment risk and operational risk of the company.*

*But because there are regulations – especially in Germany – it comes under the umbrella of risk management to ensure compliance, as well.*

*Now, you could say that the lawyers are also technically responsible for the regulation that surrounds risk – so they have to understand risk management and the compliance people than have to implement these rules within the risk management department.*

*I would say that risk management and legal are complimentary to compliance for any company that follows the concept of three lines of defence. The first line of defence is the business – which means the people who have to follow regulations as part of their day-to-day job – then the second line of defence is the oversight. There are only two functions: Risk and compliance – and the third line of defence is internal audit.*

*Therefore, the independence is important for compliance to fulfil the role as an oversight function. In order to oversee other people´s work compliance needs to be independent and not connected with the business!*

*That importance is also reflected in many regulations such as MiFID. The whole idea is that if you don´t separate compliance from the business, it cannot have a oversight function. Bottom line of this separation is a different reporting line and an*

*independent remuneration system. If you determine the compensation for the compliance dependant on the success of the business, then you can say that compliance has a conflict – because, if we stop the business, we will not get rewarded. On the other hand, if the success of the business means that compliance gets better rewarded there is an inherent incentive for compliance to close an eye. Therefore, risk and compliance must be independent.*

*Then the job of compliance as part of the second line of defence is to implement and monitor compliance with relevant regulations.*

*Compliance has three main functions: One is to advice – the advisory role entails first of all, understanding what are the rules that are applicable to the business. Now, that is where the overlap is with legal. Legal has the same advisory function. So, you must understand, what are all the rules out there relevant for my business. Once we know which rules are relevant, we have to jointly understand what they actually mean to our business. Once this is clear, compliance takes over and implements them.*

*For example, an advice could be that you need to have telephone recording – so how do you go about recording? Who are the people that need to get together to implement recording? Is it IT, data protection, sales, trading, etc. – this is all about interpretation. Compliance has to be able to bring this requirement to life – and then help to implement – help to develop and test a proper process and afterwards stepping away and monitor – so that is the advice part.*

*The second part I would say is training. Training is about making sure that those people in the business understand what they need to do. The compliance training that we do at the moment is in fact not at the level that is should be. First of all, it is about training the understanding of relevant regulations – what is this regulation about and what does it mean to your daily business? The second part of training relates to processes. So, once you have implemented a particular process you need to train your people on that process. Insider trading is a good example – people have to learn how to follow the MNPI process. People must understand that "this" is the policy, "these" are the requirements and "this" is what you have to do. That last step – the "what must you do (to properly follow the process)?" is often missing. You rather just put a document there and tell them that is the policy on insider dealing, but then the people read it and may still not understand what that actually means for them – so the next level would be to train them better on the policy.*

*The third function of compliance is monitoring. Monitoring is like: "Now that I have taught you how to do this, I let you run with this. But every so often I come back and I check you!" – And the bad news is that, if I find something that is not working, I will have to report this – because that then becomes a breach of a procedure. So, the idea is that compliance comes to show and explain the people on the business side what they need to do, but after they have understood this, it becomes their responsibility to life to this and compliance will come back to check. It is a little bit of "carrot and stick".*

*R: That is a very interesting explanation – so if I summarize this, there are three parts that you mentioned: To understand the regulation, to provide advice, to help implementing processes, to provide training and to monitor. If I summarize this – what this actually means is changing the culture in the firm - isn´t it?*

*I: The culture in the firm – that goes back to your initial question "who is responsible for compliance?" – It is not compliance! This is always a wrong impression that people have, and I keep reminding them. Not compliance, but the people – everyone working in the company is responsible for compliance – which is why we say: "Compliance is for everyone!" It is not just the managers that need to be compliant with the laws. The manager´s job is to ensure that the part the business is responsible for is compliant – compliant with all relevant laws, regulations and procedures. Procedures are important as well, because sometimes procedures can go beyond laws and regulations. For example, sometimes we may say we don´t want "this", because it has implications on other parts of the company group or on the reputation. In this case it is not because we cannot do "this" – we can do "this" - but we chose not to do it. So, that´s a company policy – your job as an employee is to comply with everything that the company says that you cannot do – that is where compliance comes in to help and to monitor.*
*It doesn´t really matter, why you have to comply with a rule. The only moment, when I would consider changing or allowing exception would be, if someone explains that this procedure doesn´t work for him. Let´s say you put a limit on inviting clients to restaurants – let´s say 250,- EUR and the sales colleagues says that is impossible I cannot work with such limits. Alright, than compliance will bring this up as a challenge – go back to the committees that can make such decisions and present the*

*problem there – if they then say it is now 500,- EUR than this is also fine for compliance. But, than we will check staff on the limit of 500,- EUR. It is not the decision of compliance, whether 250,- EUR is too high or too low. If the management excepts that 500,- EUR is the right limit it means that the management is willing to accept a higher level of risk.*
*What I am trying to say here is, that also compliance has to respect such a policy – compliance enforces – makes sure that the policy is followed. If the policy is wrong, we have of course our responsibility to highlight why we believe that is wrong, but compliance does not decide to change the policy itself.*
*I would say, the culture part is true: If compliance is successful, then the compliance with regulations has been transformed from a responsibility of senior management downwards to everyone in the firm. We do this by simply embedding those processes into the daily work of the people. They don´t even know why they do it. If I open an account I fill in the forms and rely that this is the right thing to do – this is also "compliance", because there are internal procedures that explain how the forms need to be filled in and if these procedures are followed than this is "compliance". That is what I mean by bringing regulation into a process, implementing it and making sure that people are trained and know how to work according to these processes. Then they are fine, and we are all sharing the responsibility.*
*It is a "flow-through" – taking one of these things alone is not meaningful – you have to see that you take one thing from the outside and you bring it to the inside – and then it comes from the top and filters through the organisation. The minute it filters out to everyone in the organisation, then everyone is responsible, and everyone is compliant.*

*R: Thank you – that is a very interesting point. But if I think about this than this is describing only one moment in time – because - we have to think about where are these regulations coming from. They are coming from outside, from a lawmaker or a regulator and they are changing all the time. For example, probably 30 years ago nobody really cared, if you invite someone for 250,- EUR to a restaurant – but know we care, because there is new regulation. So, there seems to be a constant impact on the company´s and compliance helps to implement that. Thereby compliance is constantly changing the culture in the firms. Do you agree with that?*

*I: I think most of the changes are of the evolutionary type. It is not like you have something that completely changed the way we do our business. I mean the regulations are out there for investor protection or to ensure that the markets are efficient. There are very few big high level topics that are not known and addressed in the regulation – and then you have different processes that came out of these requirements – and there are the ones that are relevant at the time – over time they become less relevant or they change. Think about financial instruments under the MiFID regulation. The instruments have changed from simple equity and fixed income to complex derivatives. Now the original regulations do not contemplate these types of new instruments and complexity – and over time regulators have acknowledged this. At first, they thought that derivatives should not be in scope of this kind of regulation, but if you look deep enough you understand that they actually should be in scope of the regulation and have to be captures. But can they be handled and dealt with in the same way? – No! – So, can you monitor a derivative in the same way as you monitor equity? The answer is no! – So, then how do you monitor a derivative?*

*That is when you have to "evolve" the existing regulation – and in this way it becomes complex. It is actually not new. It is a new heading under the same topic. I think there are not many new high-level principles – but there are a lot newer regulations attached to specific parts of regulation. Look at market abuse regulation – that used to be conflict of interest oriented – we have been looking into this for years. Why do we now have a new Marked Abuse Regulation coming up this year? The reason is that there are so many new topics that have not been covered under the old one. Is it new regulation?*

*I think it is not really new regulation. But it is now wider and more defined, and it gives more clarity. Therefore, to answer your question is not so straightforward like "this is new and this is old". The complexity and the big impact of this for the firms is, that when new regulations are coming out, they don´t drop old regulations. The new regulations exist in addition to the whole bunch of regulation that is already out there. It is never quite clear, however, how the new and the old regulations can be brought together. In other words, that is where regulation is often not properly understood. I guess the people drafting them also don´t understand them deep enough. So, they know what they deal with today, but they don´t know why it was like this 10 years ago. Rather than trying to understand what 10 years ago means, they*

*say: "Please follow the new one plus what we told you 10 years ago." – which means for us as a firm that we have constantly to add to what we do today. For compliance this means to re-assess, if the existing processes are still O.K. or if they need to be enhanced – or even new systems must be implemented to meet the new requirements and at the same time comply with the old requirements.*

*R: O.K. can we talk for a moment about the interaction between the firms and the regulators? I think there are also other important stakeholders in this process – like consultants or external auditors, etc.*

*I: Yes, actually the regulators are smart, because they don´t trust the companies. That is why they hire external auditors – which the firms have to pay for. They independently testify that everything is O.K. or report any issues back to the regulator.*
*The regulators have an independent oversight, but the auditors are also responsible towards the company. That is why they will always describe their audit reports in such a way that it narrows down their responsibility. For example, they will say that they did a sample-check. So, they can than argue that based on their sample they did not see anything – but this is not to say that there really is nothing to find.*
*Nevertheless, the regulator uses the auditors – especially for the funds – as an independent pair of eyes. In Germany there is also an audit report on the aspects of the company (in addition to the fund audit).*
*At the same time, you have all the others – you call them stakeholders – but these stakeholders are in reality nothing more than a "discussion group". The trade associations for example the BVI in Germany or the equivalent in the UK – their role is to represent their members – who have a lot of "grievance" against regulations – "this is too difficult to comply" or "that cost too much money, if we have to implement this" etc. – The whole idea is that the industry has views and the industry association´s role is to represent these views towards the regulator or law makers. So, they will make sure that their member´s voice is heard by the regulator.*
*On the other hand, the regulator has not to deal with 5.000 independent voices but gets an information from one organization and they can be sure that only such topics are raised, which are relevant at least for the majority of the firms in the industry. So, if something is a problem for 10 firms, it is not a problem. But if something is a*

*problem for 4.900 firms it is a big problem – the regulators immediately get this sense of proportion.*
*But where this has gone wrong is, when the trade association has started to become its own rule making body. For example, when the BVI says "we provide the following guidance…". – Now, is that guidance provided by the industry association sanctioned by the regulator? Is it already approved by the regulator or is it just the view of the industry association?*
*That is why taking advise from the industry association is not necessarily protection - because they don´t have the rule making capability.*

*R: No – they don´t have the rule-making capability – but do you think that a kind of group aspect may also play a role in this process? I give you a different example: Very often we do things, which are socially acceptable in the group we live in. For example, if all your friends are smokers, you will consider smoking to be O.K. – whereas, if none of your friends are smokers, you may feel bad, if just one person in the room lights up a cigarette…*

*I: Well, it is true – most of the time it is not clear what the role of the trade association really is. Most of the time they know what they are supposed to be doing, but it is very hard for them. If you have a very passive trade association, which does nothing but collecting views – that is not doing its job. It can also - as part of understanding of its own role create guidance – I told you about guidance – but that guidance is based on the fact that they understand the regulation and it is showing how the regulation can be implemented in the industry that they represent – they know "in my industry that is what will work". Therefore, the people working with the trade associations need to have this knowledge. They also need to be close with the regulator in order to come up with a useful guidance – maybe not a "definitive" – but just a "useful guidance".*
*From place to place the regulators can have a view to approve or accept the guidance given buy the trade association – generally not.*
*I think I, would say that in most countries the industry associations have very close connections with the regulator. They are probably quite comfortable in giving you some guidance – knowing that this is not going to be completely other direction as the regulator is going – it may not be a 100% - but it is not completely wrong.*

*Then there are the other ones – discussion groups are not helpful, because if 10 people say: "We are doing it!" Then that does not mean it is right. If you got a group of 10 people all saying, we should not report this to the regulator than that does not mean that this is right! Or, if they say, we will do this just because we are the 10 biggest players in the market and nobody is going to stop us, this is also wrong, because regulation is not about size.*
*If you don´t meet a rule than it doesn´t matter how big you are. So, having 9 other friends that are doing this wrong doesn´t make you right, either! There were some really big mistakes made because of this – I mean the market timing issues in the USA for example – everybody was doing it. At least 10 firms got fined and that shows that they were not doing it right – everybody was wrong!*

*R: That´s a good point. It actually brings me to another interesting question: What triggers firms to spend money and to make sure that they are compliant? I would say, we can be compliant at different levels – we can buy a let´s say a trade monitoring system for 10.000 EUR, I can also buy a system for 100.000 EUR or for 1.000.000 EUR – so if you think about different rules – and I don´t refer to your specific company – I refer to your personal view on that question – what do you think really triggers a company to comply or not comply with regulations?*

*I: I would say the very basic expectation of a firm is – you comply, or you will not be able to be in business. I think that is the fear – because in every regulated marked the first requirement is that you have to be authorised – which means that you have to comply with a set of rules and regulations – the authorisation is your license to operate in that market – you lose that authorisation – you cannot operate - your business is non-existent! So, it is that fear factor – it has to be.*
*The other one thing that comes out of the authorisation is sanctions: If you do something wrong than there is the fear of being punished. The punishment can come in a variety of ways. One is financial penalties which means that you get fined – but there can also be a "reputational sanction" – so your non-compliance is published and the whole world will know that you are doing something wrong.*
*The ability to keep clients and to win new clients is sometimes affected by your reputation for being non-compliant – which is something we see more and more today – because regulators are becoming gradually more prepared to release this*

*information. For example, whenever they have an official sanction against a firm, they will publish it on their website. The press is of course very interested in getting this kind of news from the regulators and publish it, too. – Now the reliability of the press is not always 100% - although the press is tending to get it right in order to not get suit – but the most reliable source is the website of the regulators.*
*Regulators are using this as a weapon in order to deter companies from doing something wrong. So, the fine could be a sum of money – which is not detrimental to the firm – but the fact that it is being published is (detrimental). – Why? – Because in RFPs there are always questions asking the firm, if there have been any sanctions or regulatory findings – going back could be three to five years – now what is never quite clear is how does this impact your scoring. If you think about it – every big firm existing today had some kind of finding from a regulator – and they still have plenty of clients. So, does it mean, if you have been fined for insider trading you will not get this client?*
*I don´t know the answer – but of course the fear from a firm's perspective is that a client can turn back and say that it is difficult to hire you, because you had a regulatory finding. – That is always the fear – has it ever happened in reality – I don´t know. Like I said, every big firm – including Blackrock – has some kind of finding – and still they have plenty of clients and are winning new mandates.*
*Where this could be a big problem is when you are not performing – and you are having difficult relationship with your clients. This adds to reasoning that a client can put together to fire you. It is almost like a client already want to end a business relationship and then he finds something bad about the firm in the newspaper and this will than certainly be used as an argument to end the business relationship – so it makes it easier for a client to end a business relationship and that is the fear that the firms have.*

*R: Yes, if you think about the recent VW scandal in the news – I am not even sure, if they finally really lost too many clients…*

*I: My view is that it is not clear. If a regulatory finding will put your business in a bad position – if you are big enough – for a small firm this will absolutely be a problem! – for a small firm like a one man financial advisor – and you are fined for improper record keeping resulting in a situation say that your client´s assets have*

*been mixed up with other assets – clients will be afraid to give money to this person so that he mixes my money with his own money – I would immediately take my money out – but if you are Blackrock – I would say I don´t worry they will take care of this somehow.*

*That is what your expectations are. It doesn´t have the same impact on everyone – but of course the fact that it is known – you will always have this fear that somebody will take this seriously and will jeopardize your business. This could happen at the RFP stage or also with on-going client relationships – you know we have on-going client due diligence every year – so it is a fear factor.*

*Does it add value in the selling proposition, if a firm has a strong compliance and no regulatory sanctions? I would say yes. You can, in some cases, add a certain amount of importance to your attitude towards compliance. I think that is also important – because clients give you their money to manage and yes, there is the performance that they expect – but how do they know that a firm is doing this properly? – Making a wrong investment is an investment decision: "I should have bought this, but I bought that, and this was not as good" – This is the investment decision - but does the firm have a process that ensures that a client is been treated fairly? – If the firm has a good idea, is it ensured that I also benefit from that good idea and you do not favour another client? –*

*That is the process – the compliance is responsible to ensure that this process is properly in place. Allocation is one example of treating customers fairly. Is that process sound? Who is checking it? etc. – This is what I mean by – "if we can demonstrate a strong compliance process" – you can use that in your marketing, and you can give a lot of confidence to the clients. – For example, in our XXXX business, when we know that there is a third-party buyer next to XXXX as the main investor – what about the remaining 35%? – How do we ensure that every third-party client has the same opportunity to benefit from this 35%?*

*If you can demonstrate to a client that we have a strong policy and that is administered by compliance, you can add a lot of comfort to the client.*

*Also, the ability of a firm to detect non-compliance with a process is strength – and that is really something, which will add value.*

*R: Yes, that is true – that brings us a back to our initial discussion about how compliance influences a firm's culture – that compliance helps to develop a good compliance-culture – and, if a firm has this culture than clients will have more trust.*

*I: Yes – and those trust elements are far more important when you have non-performing funds. When you have good performance, nobody cares – but if the performance becomes an issue than these trust elements become really important. Let´s say the markets are going downs and there is an increasing liquidity risk – who is monitoring this? Who ensures that I will be treated fairly? Are you selling my assets at ridicules value and taking advantage of the situation? – I really believe in times of good performance clients don´t rely too much on these elements – but when the markets are not performing, they really want these controls to be there in order to feel safe and protected. I think there is a changing importance of compliance for clients depending of market situations.*

*R: That is a really interesting point – thank you! That covered basically everything – maybe one last point that I would like to ask you is – since you are working for 30 years in compliance – what do you think will be the next big challenges in compliance? How do you envision compliance to look like maybe in 5 or 10 years?*

*I: Well what I like to see as a Compliance Officer would be, compliance processes run real time. I like to see these processes as part of a dashboard, which means that you can look at the dashboard and you can see what is happening. – You can see alerts when something is not working. - I could imagine to look at a screen with little circles and everyone is representing different tests (of a process) – there would be one for asset allocation, for IPO, etc. – each one is running real time – and if something is not working it blinks – that´s than what you look into and where you will focus at – that is what I think compliance should look like from a monitoring-perspective.*
*Of course, the cultural part of it is still the really important part. Being able to make everyone realize that compliance is with "them" and not with the compliance department.*
*The function of compliance should be an advisory function to tell people what needs to be done. But ultimately everyone should understand that it is there job to act*

*accordingly and to follow the rules and processes in everyday business. I would say, in the future that would be the biggest development to me – to make everyone "own" compliance.*
*From a monitoring-perspective I would say it would be the best to see everything at real time – that would enable the Compliance Officer to take a step back and only monitor what is not working properly. My example would be like working in a nuclear power plant: Someone is sitting there and is looking at thousands of different scales and if something is not working than that is the one you check. – But every process has got something checking it real time – everything is implemented in a system – we have a trading system today that trade automatically – what is there to stop us to capture this? – Pulling out the information from the system as something is happening – real time? – What is there to stop us? – The technology is already there.*

*R: Thank you – I like your metaphor with the nuclear power plant –*

*I: Yes – you see a red light – it´s going to blow up and you have to stop it! To me that would be the ultimate kind of aspiration.*

## Appendix 8 – Example of Memo

Memo on interview 3

Date 18.03.2016

*The following key topics emerged in this interview:*

***Responsibility conflict between Compliance Officer and board***

*Informant said: "Who is responsible for compliance? – It is not compliance" "So it is an expectation by the management that somebody else is responsible" (for compliance). There seems to be a clear conflict.*

*As legal requirements are embedded into internal procedures, there is sometimes an overlap with the oversight from a manager over his employees and from compliance over the same employees. This informant has the view that the respective line manager or ultimately the board holds the ultimate responsibility.*

***Perceptions on regulation***

*According to the informant there are two types of regulation: 1 general "policy-type" and 2. "prescriptive-type".*

*Furthermore, this informant believes that most regulatory change is "of an evolutionary type". He explains that this means for him there are rarely new principles embedded in a new regulation. In his view new regulation is often just catching up with new complex business models. The principles remain however the same. He mentions the example of MiFID regulation on financial instruments. This regulation was originally designed for equity and fixed income instruments. When companies started to use more derivative instruments the regulator "updated the law" to clarify how the existing principles would need to be applied for derivative instruments.*

*He believes that problems arise, as the lawmakers do not drop existing regulation, but add new regulation on top. This creates complexity for the business.*

*Note: The question is, if the business models have become more complex in the first place…?*

***Role of the Compliance Officer***

*Informant states that the CO should "bring law into life". He explains that this*

*means to "translate (legal) requirements into processes". Compliance helps to design adequate internal processes and internal policies. Compliance also provides training about legal requirements and internal processes to staff. It is however the job of every staff member to life-up to these processes. Compliance second role is to monitor, if the processes are really followed.*

***Role of the Risk Manager***

*Informant explains that risk management is responsible "to manage the companies risk appetite". The business involves various risks (credit risk, business continuity risk, operational error risk, etc.). In some jurisdictions like Germany, regulations provide guidance about which risk categories need to be managed by risk management. One category can than include "compliance risk) (e.g. in Germany) – in this case compliance becomes part of the overall risk management responsibility.*

***Role of the legal department***

*The role of legal is to help with the interpretation of legal text. Legal has therefore an advisory role. In this advisory role legal often overlaps with compliance.*

***Three lines of defence***

*"Risk management, legal and compliance are complimentary for any company that follows the concept of three lines of defence." 1. Line is described as "the business" (meaning every staff member). 2. Line is exclusively risk management and compliance. The 2. Line must be independent, as it is the job of the 2. Line to oversee other people´s work. 3. Line is audit.*

*As part of the 2. Line, compliance will provide advice, training and conducts monitoring – therefore compliance is bringing law into life.*

***Role of External Auditors***

*Informant considers External Auditors as agents that monitor the firms on behalf of the regulator but get paid by the firms that they certify. He believes that this puts the Auditors into a conflict of interest. As a consequence, Auditors may sometimes "overlook" findings to protect their business.*

***Role of the Industry Association***

*The Industry Associations are a "coordinator" between the industry and the regulator / lawmaker. The industry associations collect views from all members and reports consolidated feedback to the regulator. This is efficient and helps the regulator. However, the problem with this is that larger companies have more power and smaller companies are easily over-heard.*

*He is also sceptical about "discussion groups" and mentioned that even, if 9 out of 10 decide to use a certain interpretation that does not guaranty that this makes it legally correct – he mentions the market timing scandal that happened in the USA and where more than 10 large asset managers were all doing the same market practice and have all been fined by the regulator.*

*He is also critical about "guidance" provided by the industry associations. He explains that industry associations are sometimes critiques for being too passive. They then start to engage in the interpretation of law and provide "guidance".*

*It is however not clear, if such guidance than becomes binding or has any legal consequence. What happens if someone is not following this guidance? Will the regulator fine such a company?*

***Motivations for Compliance***

*Informant believes that "the fear of punishment" motivates companies to abide by the law.*

*Especially the fear of losing the* ***reputation*** *is a strong motivation. He explains that companies do not fear the fines imposed by regulators. What they do fear is that a sanction will be made public by a regulator. This cause bad reputation.*

*"Regulators are using this as a weapon"*

*Fear of reactions by the* ***clients*** *is another strong motivation. He believes that fines and bad reputation can destroy the trust relationship between a firm and its clients. This should be avoided. The consequences are seen stronger in times of bad performance. If the markets are up, nobody cares about compliance or reputation, but if the clients start to lose money, they want to be sure that they can really trust the firm and that they are being treated fairly.*

*A record of sanctions will also harm the ability to get new clients. Most clients use a "score card" to evaluate their asset manager and negative compliance issues are a score factor.*

*Lastly, he believes that negative regulatory records are even more severe for smaller firms than for larger ones. A small firm easily loses its creditability, if one or two staff members have been fined. In a large firm the consequence is less, as one or two people can easily be replaced.*

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