ETHICAL FINANCE AS A SYSTEMIC CHALLENGE: RISK, CULTURE, AND STRUCTURE

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In recent years, there has been no shortage of scandals involving fraudulent, predatory, and otherwise ethically unacceptable behavior on the part of large U.S. and non-U.S. financial institutions. Reverse redlining and targeting of racial minorities and other vulnerable segments of the population for subprime mortgages, collusive price-fixing in the world's most important interbank lending and trading markets, and fraudulent creation of client accounts by bank employees pressured to generate fees for the bank are only some of the recent examples of such blatantly unethical behavior. Much of this behavior was also directly implicated in the generation of unsustainable levels of risk in the financial system, which led to the global financial crisis of 2008-2009.

Not surprisingly, industry regulators and scholars of financial markets have been increasingly vocal in their criticisms of the financial industry's systematic failure to maintain high ethical standards of business conduct. Much of the regulators' and academics' attention in this area is focused on individual financial institutions' apparent inability to foster a strong internal culture of pursuing market objectives through ethical and socially responsible means. Accordingly, the potential remedy for this problem is often seen as a matter of improving the firms' culture of risk-taking, so that they develop a genuine commitment to seek private gains without creating systemically destabilizing risks or otherwise endangering the well-being of their clients, creditors, and the rest of the society. In effect, this recent "ethics turn" in financial regulation recasts firms' "risk culture" as a crucial determinant of success, or failure, of the post-crisis search for systemic financial stability.

This Article analyzes the principal themes in the newly reinvigorated public debate on the role of ethical norms and cultural factors in financial markets and identifies its key conceptual and normative limitations. It argues that the principal flaw in that debate is that it tends to ignore the critical role of systemic, structural factors in shaping individual firms' internal cultural norms and attitudes toward legitimate busi-

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ness conduct. Reversing the causality assumption underlying the current academic and policy discourse on institutional culture, the Article discusses how broader reform measures seeking to alter the fundamental structure and dynamics of the financial market—on a macro- rather than micro- level—would profoundly, and far more effectively, alter individuals' and firms' normative choices and attitudes. The key to making finance ethically sound, therefore, is to make it structurally sound – and to do so on a systemic level.

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> *"[I]mproving culture in the financial services industry is an imperative. This endeavor is important in order to ensure financial stability over time, but also to ensure the public trust in our financial system."*[1]

[1] William C. Dudley, President and Chief Executive of the Fed. Res. Bank. N.Y., Remarks at the Workshop on Improving Culture and Behavior in the Financial Services Industry, Enhancing Financial Stability by Improving Culture in the Financial Services Industry (Oct.

"Ethical problems in organizations originate not with 'a few bad apples' but with the 'barrel makers'."[2]

INTRODUCTION

The global financial crisis of 2008 has underscored the urgent need to rethink how financial firms ought to manage risk, and do so not only for the sake of generating good results for themselves and their clients but also for the sake of keeping the entire financial and economic system from collapse. The most immediate and recognizable manifestation of this attitudinal shift is the explicit focus of post-crisis legal and regulatory reforms on systemic, as opposed to entity-level or purely bilateral, implications of financial institutions' business activities. In the aftermath of the crisis, law-makers and regulators around the globe embraced the goal of safeguarding systemic financial stability as their core responsibility and, accordingly, adopted an overtly macroprudential approach to overseeing financial firms' operations.[3] In practice, this shift manifested itself in the promulgation of various new—or newly strengthened—mandatory limits on financial institutions' ability to incur leverage, make high-risk proprietary trades, or otherwise increase the vulnerability of the financial system to potentially contagious shocks.[4]

In recent years, however, U.S. and global financial regulators deliberately expanded their focus beyond traditional rule-making and embarked on a coordinated campaign to improve the ethical standards of business conduct and the internal culture of prudent risk-taking in the financial services industry. It has long been recognized that bankers' attitudes and actions are shaped not only by the "explicit" force of externally imposed laws and regulations but also by the "implicit codes of conduct" that exist within their firms.[5] In a canonical essay written more than thirty years ago, Gerald Corrigan argued that, in exchange for the publicly-conferred benefits uniquely available to them, banks have an obligation to align their implicit codes—and their actual conduct—with the

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20, 2014), (transcript available at https://www.newyorkfed.org/newsevents/speeches/2014/dud141020a.html).

[2] James O'Toole & Warren Bennis, *What's Needed Next: A Culture of Candor,* 87(6) HARV. BUS. REV., Jun. 2009, at 54.

[3] For in-depth analyses of the post-crisis shift to macroprudential regulation, see, e.g., Robert Hockett, *The Macroprudential Turn: From Institutional 'Safety and Soundness' to Systematic 'Financial Stability' in Financial Supervision,* 9 VA. L. & BUS. REV. 201 (2015); Gabriele Galati & Richhild Moessner, *Macroprudential Policy—A Literature Review (*Bank for Int'l Settlements, Working Paper No. 337, 2011), www.bis.org/publ/work337.pdf; *Int'l Monetary Fund*, *Macroprudential Policy: An Organizing Framework* (2011), https://www.imf.org/external/np/pp/eng/2011/031411.pdf.

[4] *Id.*

[5] E. Gerald Corrigan, *Are Banks Special?* FED. RES. BANK OF MINNEAPOLIS ANNUAL REPORT (1983).

public good.[6] In practice, however, there has been little evidence of such an alignment. To the contrary, the events of the last decade revealed pervasive patterns of corrupt behavior and systematic indifference to the public costs of excessive risk-taking on the part of large financial institutions.[7]

This fundamentally anti-social behavior was put on full display, for example, when the post-crisis congressional investigation uncovered and documented numerous cases of financial institutions' conscious disregard for, and often deliberate concealment of, unacceptably high risks built into subprime mortgage loans they originated, packaged, and sold to investors.[8] One of the most troubling revelations in this respect was that, in the vast majority of these cases, banks' and their employees' socially harmful and ethically questionable business conduct was perfectly permissible under the existing legal rules. In each of those instances, bankers voluntarily, and often knowingly, chose to pursue a particular privately lucrative but socially suboptimal business strategy. And, as long as mortgage markets kept going up and speculative trading in mortgage assets remained profitable, bankers showed no interest in fulfilling their public duties or prioritizing moral values over pecuniary self-interest.

Against that background, the recent launch of a deliberately coordinated and publicized regulatory campaign to "improve culture" in the financial services industry represents a logical extension of post-crisis reforms aimed at bolstering the resilience and stability of the financial system. More broadly, however, it signals regulators' resolve to elevate the significance of ethical considerations and cultural norms as levers of socially desirable change in the financial marketplace. Not surprisingly, scholars, policy commentators, and industry experts differ in their assessments of the potential efficacy of this "ethics and culture" turn in financial regulation. Some enthusiastically embrace this moment of regulatory "softening" as consistent with the financial industry's enlightened self-interest. Others express varying degrees of skepticism with respect to regulators' ability to translate their moral exhortations into actionable guidance for financial institutions' and professionals' business conduct. In any event, this latest regulatory turn has spurred a new wave of writing and thinking about the role of ethics and culture in modern finance.[9]

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[6] *Id.*

[7] *See infra* notes 28–33 and accompanying text.

[8] STAFF OF S. PERMANENT SUBCOMM. ON INVESTIGATIONS, 112TH CONG., WALL STREET AND THE FINANCIAL CRISIS: ANATOMY OF A FINANCIAL COLLAPSE (Comm. Print 2011), http://hsgac.senate.gov/public/_files/Financial_Crisis/FinancialCrisisReport.pdf.

[9] *See infra* Part III.

The purpose of this Article is twofold. First, it attempts to survey the principal themes in the newly reinvigorated public debate on the role of ethical norms and cultural factors in financial markets and to identify key conceptual and normative limitations of that debate. Second, the Article seeks to push the debate beyond its current limits by shifting the focus away from the predominantly individual entity-level analysis toward the broader systemic dynamics of modern finance.

Mapping out the principal themes in the current debate on the ethics and culture in the financial services industry is an important analytical exercise, especially because that debate is so wide-ranging as to appear lacking in coherence. This exercise brings into relief the post-crisis shift in our collective understanding of how various cultural factors fit into and shape the dynamics in the financial sector. It also yields several important insights into what is missing from the conversation, and why "improving culture" of finance in practice remains such a frustratingly elusive task. The Article argues that, for all its richness, the current debate is not able to generate a cohesive and workable solution, to a great extent, because it operates on the basis of a fundamental misdiagnosis of the problem as a micro-level phenomenon. The principal focus of academic and policy discussions is on an individual financial services firm, a discrete corporate entity whose organizational culture constitutes the primary object of proposed reforms. It is implicitly assumed that "correcting" the norms and attitudes toward risk-taking within individual financial firms would automatically improve both the industry-wide risk culture and the long-term stability of the financial system.[10]

The Article challenges this paradigm and offers an alternative, macro-structural approach to reforming the culture of risk-taking in the financial sector. As argued below, individual firms are not free agents exercising their morally salient organizational choices in a vacuum. These firms are interconnected elements of a bigger whole—the market, the industry, the financial system, the economy at large—and their individual (or micro-level) choices and strategies reflect certain fundamentally collective (or macro-level) choices and strategies. Each firm continuously absorbs, processes, operationalizes, and hierarchically orders specific norms and responds to specific incentives generated within these surrounding institutional layers. Accordingly, a meaningful change in the culture and practice of risk-taking at the level of a financial services firm requires, first and foremost, a meaningful change in the basic structure and dynamics of its surrounding layers and, ultimately, of the financial system as a whole. The Article argues that, in order to make individual banks' internal ethical standards and cultural practices more

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[10] *See infra* notes 97–101 and accompanying text.

"other-regarding" and conducive to prudent risk-taking, it is critical to change how the broader institutional context in which these banks operate—the market, the industry, the financial and economic system—incentivizes continuous generation and amplification of socially excessive risk.[11] In that sense, "improving culture" in finance is an inherently systemic challenge, which can be met fully only if the focus of reforms is expanded beyond the narrow limits of the firm to encompass the outer structural layers of the financial system. Only a structurally sound system of finance can also be ethically sound.[12]

It is important to note from the outset that this Article focuses explicitly and exclusively on the role of ethics and culture as factors either facilitating or hindering the key post-crisis policy goal of maintaining systemic financial stability. Hence the use of the term "risk culture"—or "culture of risk-taking"—throughout the discussion.[13] The Article's main concern, therefore, is with the normative determinants and content of financial firms' and individual professionals' ordinary business judgments and organizational choices. More straightforward instances of unethical or criminal conduct, such as fraud or misappropriation of customer funds, are generally outside the scope of this Article.[14]

Relatedly, the Article uses terms "culture" and "ethics"—both of which are notoriously complex, contested, and difficult to define with precision—as largely synonymous, insofar as they refer to the "soft" normative and relational determinants of financial firms' and professionals' business conduct. The Article does not seek to weigh in on any academic debates on what "culture" is, or is not, as a general matter.[15] Nor does it aim to dispute—or intentionally blur—any conventional or philosophical

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[11] *See infra* Part IV.

[12] *Id.*

[13] *See infra* Part II.

[14] Without a doubt, preventing such immoral and illegal conduct on the part of financial institutions and professionals is an important public policy objective. Yet, the creation of systemically destabilizing—and particularly socially harmful—financial risk far more often involves people taking actions and making choices that are both legally permissible and normatively acceptable in the context in which they operate. *See, e.g.,* Robert Hockett, *Bubbles, Busts, and Blame?* CORNELL LAW SCHOOL RES. PAPER NO. 11–09, *available at* https://papers.ssrn.com/sol3/papers.cfm?abstract_id=1805930 [hereinafter, "*Bubbles, Busts, and Blame*"] (arguing that socially harmful asset bubbles and busts happen even without any illegal or immoral conduct by putatively "bad guys"). It is this kind of legally permissible and not unequivocally morally wrong conduct that is especially difficult to police and prevent without a significant shift in the relevant norms and cultural practices. Hence, the focus of this Article is primarily on that kind of business conduct rather than fraud or other criminal activities.

[15] There is a vast and diverse body of academic literature defining and applying the concept of "culture" in a variety of ways, often encompassing not only norms and attitudes shared by members of a particular group but also material objects and institutional structures characteristic of that group. Accordingly, "culture" is often used as a highly capacious sociological or anthropological concept. This Article, however, neither engages with that literature nor uses the concept of "culture" in that sense.

boundaries between properly "ethical" questions and questions pertaining to matters of cultural practices more broadly. As explained above, the Article addresses a very specific debate in the field of financial regulation, in which such universal terms as "culture," "structure," or "ethics" have acquired specific—and specialized—meanings. In the context of that particular debate, calls for "improving banks' culture" and "making bankers more ethical" mean essentially the same thing: ensuring that financial firms and their employees take their public duty seriously and consistently refrain from pursuing privately profitable but socially harmful business activities.[16] It is this, very practical and concrete, challenge that is at the heart of the Article and determines its scope.

The Article proceeds as follows. Parts I and II provide the general policy and conceptual context for the discussion. Part I explains the new salience of ethics and culture in the post-crisis regulatory reform as a logical extension of regulators' fundamental concern with safeguarding systemic financial stability. Part II outlines the general framework for understanding the interaction among norms, incentives, and business conduct that is at the core of the policy debate on the culture of finance. Part III discusses the principal themes in, and limits of, the current policy and academic debate on reforming the culture of socially excessive risk-taking in the financial services sector. Part IV offers an alternative approach to that task by highlighting the critical importance of addressing the structural determinants of ethical culture in the financial system on a macro rather than micro level.

I. THE *POST*-POST-CRISIS "ETHICS TURN" IN FINANCIAL REGULATION

One of the key lessons of the global financial crisis of 2008 concerns the principal importance of safeguarding stability of the financial—and, by extension, economic—system, as opposed to preventing failure of individual financial institutions. This new appreciation of the systemic aspect of financial risk-taking shaped the post-crisis prioritizing of the explicitly macro-prudential, as opposed to traditional micro-prudential, tools and methods of financial firm oversight.[17] Enhanced public regulation and supervision of large banks and other systemically important financial institutions—including heightened capital and liquidity standards, regular stress testing, more stringent disclosure and reporting requirements, etc.—is at the center of these ongoing efforts to make the global financial system safer.[18]

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16 *See infra* Part III.

17 *See* sources cited *supra* note 3.

18 *See, e.g.*, Darrell Duffie, *Financial Regulatory Reform After the Crisis: An Assessment* (2016), https://www.darrellduffie.com/uploads/policy/DuffieSintraJune2016.pdf.

To date, these efforts have met with only partial and often tentative success.[19] Formulating and then implementing workable macroprudential rules in various interconnected areas of today's finance has been a slow and difficult process. Notorious frictions and delays in the implementation of the Dodd-Frank Act, the centerpiece of post-crisis financial regulation reform in the U.S., provide a vivid illustration of this phenomenon.[20] In part, it is a function of the sheer scope and technical complexity of the regulatory undertaking. In part, however, it is a product of intense resistance to reforms on the part of the financial industry, which relentlessly defends its profitability through regulatory arbitrage and political lobbying.[21] As a result, even when regulatory agencies finally manage to issue specific rules, their substantive content and practical impact are frequently significantly weakened.[22]

In this context, the current resurgence of financial regulators' interest in the role of ethical and cultural norms in shaping financial institutions' and professionals' behavior is hardly a surprising development. Thus, beginning approximately in late 2013, U.S. financial regulators became particularly and increasingly vocal in their calls for ethically sound behavior and a culture of prudent risk-taking within financial firms.[23] Two key factors help to explain this regulatory turn to ethics and culture at this relatively late stage in post-crisis reform process.

First, it is becoming increasingly clear that the ultimate obstacle to successful regulatory reform is the financial industry's persistent reluctance or inability to internalize macroprudential constraints on its risk-taking as a matter of its public duty, a moral obligation to protect society from harm. To put it simply, even the most sophisticated and technically nuanced post-crisis regulatory requirements will fail to achieve their goal of limiting excessive risk-taking in the financial system, if financial institutions continue circumventing them in practice. And experience shows that financial institutions will continue circumventing rules, if they view them as a product of coercion rather than conviction. From that perspec-

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[19] *Id.*

[20] *See, e.g.*, Dodd-Frank Wall Street Reform and Consumer Protection Act, Pub. L. No. 111–203, § 929-Z, 124 Stat. 1376 (2010) (codified in scattered sections of 12 U.S.C.). This was the case even before the recently intensified efforts by Congressional Republicans and the Trump Administration to roll back the key provisions of the Dodd-Frank Act.

[21] *See* Gary Rivlin, *How Wall Street Defanged Dodd-Frank*, THE NATION (Apr. 30, 2013), https://www.thenation.com/article/how-wall-street-defanged-dodd-frank/; Jonathan Weisman & Eric Lipton, *In New Congress, Wall St. Pushes to Undermine Dodd-Frank*, N. Y. TIMES (Jan. 13, 2015), https://www.nytimes.com/2015/01/14/business/economy/in-new-congress-wall-st-pushes-to-undermine-dodd-frank-reform.html.

[22] *See* Victoria McGrane, *Wall Street, Banks Press to Shape Dodd-Frank Rules*, WALL STREET J. (Apr. 22, 2011), https://www.wsj.com/articles/SB10001424052748704889404576277364034089104.

[23] *See* Governance & Culture Reform: Archive, Fed. Reserve Bank of N.Y., https://www.newyorkfed.org/governance-and-culture-reform/archive.html.

tive, the increasing emphasis on ethical conduct and culture of prudent risk-taking within financial firms represents regulators' latest attempt to supplement and bolster the efficacy of the evolving "hard" law through "soft" means.[24]

Another factor explaining the heightened salience of ethical conduct on the post-crisis reform agenda is the regulators' growing—and quite legitimate—concern over the continuing erosion of public trust and confidence in banks and other financial institutions. It is well understood that maintaining public trust in the banking system is a necessary ingredient of financial stability and proper functioning of the modern economy.[25] Financial crises are typically triggered by, and further amplify, the contagious spread of mistrust and loss of confidence in the ability of the financial system to function as intended.[26]

The financial crisis of 2008 was a textbook example of this destructive pattern. Numerous analyses of the causes of that crisis revealed a disturbingly pervasive pattern of financial institutions' reckless disregard not only for law but also for basic moral considerations.[27] A long string of enforcement actions against numerous U.S. and European banks for systematic legal violations and outright fraud in connection with their pre-crisis mortgage origination and marketing practices, which kept these misdeeds in the limelight long after the crisis subsided, further reinforced the popular perception of banks as inherently immoral actors.[28] At the same time, the banking industry was hit with a new wave of fines and prosecutions for manipulating pretty much all of the key benchmark

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[24] As William Dudley put it in one of his speeches,

> Culture—within a firm or across an industry—is not determined primarily by rules or laws, though certainly rules and laws can amplify good or bad attributes. Culture comprises, instead, what people observe and do, resulting in accepted and mostly unspoken norms. Mostly, people look for what succeeds and what does not, and they try to align themselves with the former.

William C. Dudley, President and Chief Exec. of the Fed. Reserve Bank of N. Y., *Worthy of Trust?*, Law, Ethics, and Culture in Banking, Panel Remarks at the Bank of England, London, U.K. (Mar. 21, 2017), (transcript available at https://www.newyorkfed.org/newsevents/speeches/2017/dud170321a).

[25] *See* Dudley, *supra* note 1.

[26] There is a vast literature examining these dynamics, both historically and analytically. *See, e.g.*, CHARLES P. KINDLEBERGER & ROBERT ALIBER, MANIAS, PANICS, AND CRASHES: A HISTORY OF FINANCIAL CRISES (5th ed. 2005); JOHN KENNETH GALBRAITH, THE GREAT CRASH: 1929 (1997).

[27] *See, e.g.,* STAFF OF FIN. CRISIS INQUIRY COMM'N, THE FINANCIAL CRISIS INQUIRY REPORT: FINAL REPORT OF THE NATIONAL COMMISSION ON THE CAUSES OF FINANCIAL AND ECONOMIC CRISIS IN THE UNITED STATES (2011), https://www.gpo.gov/fdsys/pkg/GPO-FCIC.pdf; STAFF OF S. PERMANENT SUBCOMM. ON INVESTIGATIONS, *supra* note 8; LORD ADAIR TURNER, THE TURNER REVIEW: A REGULATORY RESPONSE TO THE GLOBAL BANKING CRISIS, FIN. SERV. AUTH. (2009), http://www.ecgi.org/tcgd/2009/FSA_Turner_Report_on_Financial_Crisis_2009.pdf.

[28] *See* Kara Scannell, *US Haul from Credit Crisis Bank Fines Hits $150bn*, FIN. TIMES (Aug. 6, 2017), https://www.ft.com/content/71cee844-7863-11e7-a3e8-60495fe6ca71.

prices in global financial markets: LIBOR,[29] EURIBOR,[30] precious metals,[31] and foreign exchange rates.[32] And, as if to show that fraud and corruption are not confined to opaque wholesale markets, Wells Fargo was caught cheating its depositors by creating millions of unauthorized accounts and otherwise siphoning off their retail customers' money.[33]

In response to these scandalous revelations—including, most immediately, those related to systematic manipulation of LIBOR and foreign exchange rates—the Federal Reserve Bank of New York (FRBNY) embarked on a high-profile campaign to "improve culture" of banking institutions.[34] In a series of high-profile speeches at high-level gatherings, top-ranking bank regulators forcefully called on the financial industry to behave in a more ethical manner, to curb its risk-taking, and to foster a robust culture of voluntary compliance with the law.[35]

The regulators framed this as a practical imperative on two principal grounds: as the means of ensuring long-term financial stability and restoring public trust in the financial system.[36] Importantly, systemic stability and trustworthiness of financial institutions are seen as two sides of

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[29] LIBOR stands for the London Interbank Offering Rate, which for decades served as the leading benchmark for pricing derivatives and debt instruments in global financial markets. In 2012, it was revealed that LIBOR was systematically manipulated by the banks submitting data used to calculate it. For a compilation of materials on the LIBOR scandal, *see* FINANCIAL TIMES, *LIBOR Scandal*, https://www.ft.com/libor-scandal.

[30] Similarly to LIBOR, EURIBOR is the key benchmark interest rate for the Euro-denominated financial contracts. *See* James Titcomb, *Three Banks Accused of Rigging EURIBOR*, THE TELEGRAPH (May 20, 2014), http://www.telegraph.co.uk/finance/newsbysector/banksandfinance/10843666/Three-banks-accused-of-rigging-Euribor.html.

[31] *See* Alan Feuer, *Banks Sued on Claims of Fixing Price of Gold*, N. Y. TIMES (May 5, 2014), https://dealbook.nytimes.com/2014/05/05/banks-sued-on-claims-of-fixing-price-of-gold/.

[32] *See* Sebastian Chrispin, *Forex Scandal: How to Rig the Market*, BBC NEWS (May 20, 2015), http://www.bbc.com/news/business-26526905.

[33] *See* Kate Berry, *Wells opened far more fake accounts than originally estimated*, AM. BANKER (Aug. 31, 2017); Stacey Cowley & Matthew Goldstein, *Accusations of Fraud at Wells Fargo Spread to Sham Insurance Policies*, N. Y. TIMES (Dec. 12, 2016), https://www.nytimes.com/2016/12/09/business/dealbook/wells-fargo-accusations-sham-insurance-policies.html.

[34] *See* William C. Dudley, President and Chief Exec. of the Fed. Reserve Bank of N.Y., at the Culture Imperative—An Interbank Symposium (Jan. 11, 2017), (transcript available at https://www.newyorkfed.org/newsevents/speeches/2017/dud170111). According to Dudley,

> The manipulations of LIBOR and foreign exchange rates prompted the New York Fed's work on culture. Of course, widespread misconduct did not originate with either episode. The timing, however, was significant. Despite the near-death experience of the financial crisis, new rules and regulations, and—in some cases—large fines and penalties, the LIBOR and FX events made clear that serious ethical and behavioral problems had persisted in the industry. I was particularly struck by how the manipulation of foreign exchange rates occurred even after the LIBOR fixing was widely known. The appropriate lessons from the LIBOR scandal did not seem to have been learned.

[35] The FRBNY's online archive contains a large number of speeches and documents from the events organized by the FRBNY since the beginning of 2014. *See supra* note 23.

[36] *See* Dudley, *supra* note 1.

the same coin. In fact, one of the most distinctive aspects of the post-crisis ethics turn is regulators' explicit emphasis on so-called "culture of risk-taking" or "risk culture."[37] Risk-taking—and risk management for their clients and customers—is at the core of financial services firms' business. Moreover, the level and nature of risk taken by individual banking institutions is subject to direct regulation and supervision by the relevant government agencies. In this context, the regulators' effort to reframe risk-taking as an ethical and cultural matter signals their desire to push financial institutions toward a new paradigm of decision-making: one that takes into account not only their own economic interests and explicit legal obligations, but also potentially socially harmful consequences of their privately lucrative and legally permissible but systemically destabilizing risk-taking.[38]

Notably, the regulators explicitly and insistently try to justify the need for the financial industry to re-establish its own trustworthiness in the eyes of the broader society by appealing to the industry's economic self-interest. This is how the FRBNY President, William Dudley, put it,

> Why should we seek better culture in the financial services industry? We do this to achieve better outcomes in terms of conduct and behavior—and, with that, greater trustworthiness in our nation's financial system. Greater trustworthiness will make it easier for the financial industry to perform its role in supporting economic activity and rising living standards. Greater trustworthiness will also make it easier to attract top talent into the industry. Without that, the industry will suffer.[39]

This "recent, vibrant, and widespread" official push for ethical conduct and culture, unsurprisingly, has reinvigorated the ongoing academic

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[37] It is worth noting here that, in the post-crisis industry-wide discourse, "risk culture" became a fashionable term of art that generally denotes a financial firm's internal attitudes and processes for identifying and assessing the risk of insolvency and other risks the firm's business activities pose to its financial survival. *See, e.g.*, Patricia Jackson, *Understanding Risk Culture and Its Challenges,* Q2 THE CLEARING HOUSE, BANKING PERSPECTIVE 48, 48 (2015), http://www.ey.com/Publication/vwLUAssets/EY-understanding-risk-culture-and-its-challenges/$FILE/EY-understanding-risk-culture-and-its-challenges.pdf ("Of the issues currently bedeviling financial services firms, risk culture is one of the foremost."). While it is difficult to draw clear definitional lines, the industry uses the term "risk culture" in a distinct, more narrowly technocratic sense. The regulators' interest in improving the culture of risk-taking in the financial sector, however, is much more explicitly normative and driven by the broader public policy interest in safeguarding financial stability and ensuring long-term economic health of the entire system.

[38] *See* Dan Awrey, William Blair & David Kershaw, *Between Law and Markets: Is There a Role for Culture and Ethics in Financial Regulation?* 38 DEL. J. CORP. L. 191, 217 (discussing the importance of "other regarding" behavioral norms in the aftermath of the global financial crisis).

[39] *See* Dudley*, supra* note 34.

debate on the issue.[40] There is a vast and varied body of literature on the role of ethical norms, psychological biases, organizational choices, and other factors loosely categorized as constituting "ethics" and "culture"—or what may be called "ethical culture"[41]—in shaping conduct of, and within, various social groups and business entities. Economists, organizational theorists, psychologists, anthropologists, sociologists, and legal scholars have long grappled with various aspects of this complex, fluid, and arguably omnipresent phenomenon. It would be futile to attempt a comprehensive review of all these different bodies of scholarship in a single article. Yet, even a high-level overview of the principal themes in that wide-ranging debate is instructive: it helps both (1) to distill some of the dominant diagnoses of and prescriptions for solving the problem of persistent ethical failures in the financial services industry, and (2) to identify key shared weaknesses of such diagnoses and prescriptions.

Before proceeding to a substantive critique of the current approaches to reforming the ethic and culture of finance, however, it is helpful to start by outlining the conceptual terrain on which the debate takes place.

II. UNPACKING THE CULTURE OF FINANCE: NORMS, INCENTIVES, CONDUCT

Terms like "ethics," "morals," "culture" are inherently difficult to define with precision.[42] Depending on the context, they may be treated either as synonyms or as substantively distinct concepts. My purpose in writing this Article, however, is not to engage in semantic line-drawing exercises or to conduct a general socio-philosophical inquiry into the nature of moral and cultural norms.[43] I do not intend to contribute to, or to utilize the latest advances in, theoretical debate on subjects like psychological motives driving human behavior, typology and organizational determinants of "ethical climates" within firms, and the like.[44] For the specific purpose of discussing the current state of the financial services industry, it makes practical sense to treat ethics and culture as significantly overlapping phenomena. For simplicity's sake, I will primarily use

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[40] Gwendolyn Gordon & David Zaring, *Ethical Bankers*, 42(3) J. CORP. L. 559, 566 (2017).

[41] *See* Awrey et al., *supra* note 38, at 194 (explaining their use of the term "ethical culture" as a function of the inherent difficulty with separating the two concepts).

[42] *See, e.g.*, Gordon & Zaring, *supra* note 40, at 561 (discussing the difficulty of defining and measuring "culture").

[43] *See supra* notes 13–16 and accompanying text.

[44] The social science literature examining these issues is vast, fascinating, and impossible to summarize effectively in the space of a short article. For a helpful overview of some of this literature, *see, e.g.*, David M. Mayer, *A Review of the Literature on Ethical Climate and Culture*, in HANDBOOK OF ORGANIZATIONAL CLIMATE AND CULTURE (2014).

"culture" as the more capacious term encompassing moral and ethical aspects of modern finance.[45]

It is also important to emphasize that the concept of "culture" in the post-crisis regulatory vocabulary has a specific contextual meaning: it is defined primarily by reference to its role as an extra-legal tool of enhancing systemic financial stability and limiting socially harmful risk-taking in the financial sector. Accordingly, this Article will use terms "culture" and "risk culture" interchangeably: we are only interested in financial firms' and professionals' "culture" to the extent it affects their attitudes toward risk-taking and compliance with prudential regulations.

With these caveats in mind, it is possible to start outlining the basic conceptual framework for discussing the causes of, and potential remedies for, the presently deeply dysfunctional culture of finance.

A. Norms

Generally, culture is understood as a complex phenomenon that encompasses the relevant community's or group's shared beliefs, attitudes, norms, as well as actual practices and patterns of conduct that reflect and support such beliefs, attitudes, and norms. In other words, any particular group's culture has both a normative and a behavioral aspect. These norms and behaviors are closely interrelated and mutually reinforcing.

As a practical matter, we may care mainly about specific conduct of group members that affects outsiders: Do their actions hurt third parties or otherwise go against broader ethical norms? In the area of finance, in particular, the overarching concern is to prevent professionals from abusing their superior informational capabilities and other advantages to the detriment of their customers, clients, and the public in general. To the extent group members' actions reflect their shared values and expectations, however, changing "bad" behavior by individuals necessarily requires changing the group's norms. In that sense, "bad" culture functions like the nutrient medium in a petri dish, which enables bacteria to grow—and the key to controlling the rate of growth of bacteria is controlling the mixture in the dish.

So, what determines the composition and other key characteristics of that medium? Some norms and expectations that underlie behavior within and across financial firms are direct products of legal and regulatory requirements and, in that sense, are externally imposed and public policy-driven. One example of such an internalized regulatory dictate is the presently widely shared norm that securities professionals have to

[45] It is important to reiterate here that this directly tracks the common usage of the terms "ethics" and "culture" in the current academic and policy debate on macroprudential financial regulation. *See supra* notes 13–16 and accompanying text.

disclose to their clients the existence of any serious conflict of interests with respect to a particular investment they are recommending.[46] In fact, most norms of professional conduct in the financial sector are regulatory or quasi-regulatory in origin.[47] These norms are typically easily traceable to and clearly specified in the applicable laws and administrative rules. For this very reason, however, private market actors do not always fully internalize and incorporate these norms into their day-to-day conduct of business. In other words, not every legally mandated practice reaches the status of a universally shared industry norm or functions as an organic group value.

Another set of less formalized but deeply internalized and pervasive norms and attitudes that shape financial firms' and professionals' culture reflects the economic profit-driven dictates of the market in which these actors operate. Perhaps most importantly, the financial system—just like the broader capitalist economy—operates on the fundamental assumption that pursuit of individual economic gain through freely-negotiated, self-interested exchange is the ultimate legitimating force in financial markets and a fundamental right of each market participant.[48] It is commonly viewed as the very raison d'être of the free capitalist market. In this context, private profit-seeking is not only an expected behavior but also a normative baseline. Accordingly, any limits on private profit-seeking derived on the basis of considerations outside of the economic exchange at hand are inherently suspect not only as a practical but also as a moral matter. In their pure form, the "morals of the marketplace," to which Justice Cardozo famously referred in 1928, entail little more than straightforward economic rationality minus outright dishonesty and illegality.[49]

Finally, the culture of modern finance is generally reflective of the fundamental moral values, principles, and beliefs prevailing in the broader community. Certain universal human norms, such as a moral norm against committing theft, clearly buttress both the endogenous market norms and exogenous legal mandates. On the other hand, universal

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[46] This is not to say, of course, that this particular norm is universally observed and never violated in practice. The point is merely that there is now a generally shared expectation of such disclosure among financial market participants, which is a direct product of the existing regulatory regime rather than any "natural" market evolution.

[47] This is especially obvious in the case of securities broker-dealers subject to elaborate rules of conduct under the federal securities laws and self-regulatory organizations' rules. *See* U.S. Securities and Exchange Commission, *Guide to Broker-Dealer Registration*: *Conduct Regulation of Broker-Dealers,* https://www.sec.gov/reportspubs/investor-publications/divisionsmarketregbdguidehtm.html#V; Financial Industry Regulatory Authority (FINRA), *FINRA Manual: Conduct Rules (2000-3000),* http://finra.complinet.com/en/display/display_main.html?rbid=2403&element_id=3602.

[48] *See infra* note 157 and accompanying text.

[49] Meinhard v. Salmon, 164 N.E. 545, 546 (N.Y. 1928).

moral norms are not easily reconciled—and often directly conflict—with the fundamental market-derived norms that glorify individualism and economic self-interest. Because these moral norms tend to operate primarily on the individual level and are inherently context-specific, however, it is difficult to trace or evaluate how or to what extent they actually influence specific conduct or the overall culture of financial firms or markets. In particular, it is difficult to discern or postulate some form of a general principle for resolving conflicts between universal moral norms and market-driven expectations and attitudes. Ultimately, it is that ever-present tension that both gives rise to the problem of defining the role of ethics and culture in the financial marketplace and makes its resolution so challenging in practice.

B. Organizational Dynamics

Organizational culture is a product of complex interaction among all of these different categories of norms, attitudes, expectations. At times, these different levels of normativity are mutually reinforcing, and at other times they are in conflict with one another. The continuous process of constructing and reconstructing a particular firm's internally shared hierarchy of norms and normatively sanctioned behavior takes place within its organizational and decision-making structure. That structure encompasses not only formalized intra-firm divisions and lines of authority but also informal relational and communicative mechanisms.[50]

The former, of course, plays a far more salient role in shaping the firm's ethical identity. For example, if the top management of the firm expressly prioritizes the firm's short-term profitability over all other objectives, the firm's cultural attitude toward risk-taking will be more overtly aggressive and disregarding of third parties' interests. This simple fact explains financial regulators' emphasis on the importance of the right "tone from the top," an intangible element that determines the quality of the firm's culture of compliance both with the law and with the general norms of ethical behavior.[51]

To complicate matters, however, the firm management's policy of rewarding privately profitable but socially excessive risk-taking—or "bad tone from the top"—is often justified as fundamentally reflecting and reinforcing the broader cultural norm of self-interest.[52] In this sense, it may not be quite as unambiguously "bad" as the regulatory rhetoric

[50] *See, e.g.*, Gordon & Zaring, *supra* note 40, at 565 ("Culture may be found within the interplay of directive action and organically arising forces.").

[51] *See, e.g.,* Andrew Bailey, Deputy Governor and Chief Exec. Officer, Prudential Regulatory Authority of the United Kingdom, *Culture in Financial Services—A Regulator's Perspective*, at City Week 2016 Conference (May 9, 2016), (transcript available at http://www.bankofengland.co.uk/publications/Documents/speeches/2016/speech901.pdf).

[52] *See* Awrey et al., *supra* note 38, at 216.

implies: the underlying norms of capitalist marketplace imperceptibly shift the scale of moral judgment, making it inherently difficult to draw clear lines between acceptable and unacceptable managerial choices. Ultimately, it is this built-in ability to appeal to such deeply held values as self-interest, individualism, freedom—however they might be interpreted in any specific context—that provides a powerful normative justification for, and therefore sustains, many socially harmful business practices in financial markets.

This illustrates how normative signaling from the firm's top managers down to its lower-level employees involves a lot more that simply making discrete choices with respect to concrete matters, such as compensation criteria. Rather, it is a continuous process of navigating through, prioritizing, and resolving conflicts among numerous layers of norms and expectations. The result of this two-way process—top-down signaling and bottom-up feedback—is a dynamic normative hierarchy: a clearly, albeit largely implicitly, established order of preferred values, judgments, and actions. This hierarchical order of shared values, attitudes, and behavioral preferences is what constitutes the firm's risk culture.

C. *Incentives*

This process of dynamic construction of a shared normative hierarchy, or continuous generation and affirmation of organizational culture, operates primarily through the structuring of incentives. The firm's top managers prioritize specific norms not only by declaring their intent to do so but, more importantly, by establishing a system of tangible rewards and punishments for their employees' actions that conform to or, conversely, contradict such norms. In other words, norms and values—whether derived from law, market, or ethics—translate into conduct through the mediating mechanism of individual and collective incentives.

This basic logic of interaction between norms, incentives, and business conduct, which shapes an individual firm's organizational culture, is schematically represented in Figure 1. The thickness of the border around each circle denotes the degree of observability of the relevant phenomena, with actual conduct being the most readily observable and norms the least observable element of the firm's culture. Solid arrows represent more directly traceable causal relationships, while dotted arrows represent more diffuse feedback and reinforcement effects.[53]

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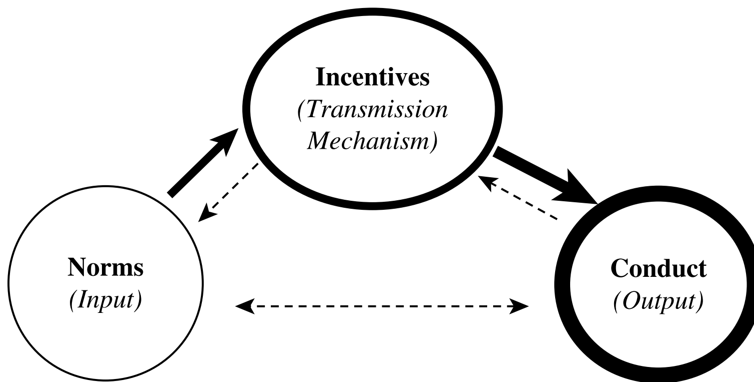
[53] This Figure is, of course, a greatly simplified schematic representation of what is a far more fluid and complex relational pattern in reality. The key point here is to show, in a simple and easy to grasp manner, the centrality of incentives as the core mechanism for translating intangible institutional norms and values into tangible behavior.

FIGURE 1



By transforming norms into actionable preferences that can be readily applied in a specific decisional context, the firm's incentive structure operates as a practical guide for employees handling the inevitable conflicts of norms in the ordinary course of the firm's business. In that sense, incentives are the principal levers for changing both the actual conduct and the norms underlying it. Understanding the sources, hierarchy, and operation of financial institutions' incentives to take risks is the key to both understanding and reforming the risk culture in the financial sector. Not surprisingly, therefore, reshaping incentives continues to be the primary target of the regulatory and academic efforts to curb systemic financial risk.

Just like norms, conduct-shaping incentives emerge in response to different factors and reflect different internal and external dynamics. Some of these incentives are formally established within the firm in accordance with its internal governance procedures; others emerge organically as informal mechanisms of group approval or disapproval. Though complex and contextually rich, this intrafirm incentive structure is generally easy to identify. It is well documented, for example, in firms' official employee compensation or promotion policies. And, as a practical matter, it's not difficult to figure out what kind of behavior gets you a bonus or bragging rights, and what kind of behavior gets you fired or shunned.[54]

However, managers' decisions to reward or punish particular actions or attitudes within their firms are themselves shaped, in significant measure, by their perceptions of what types of firm actions are rewarded or punished in the broader marketplace. For instance, if firms aggressively generating high short-term profits consistently outcompete firms conservatively focused on long-term sustainability, any firm operating in

[54] *See, e.g.*, Dudley, *supra* note 24.

that market will be under pressure to structure its internal employee incentives so as to maximize its own short-term performance.

Despite its apparent common-sense simplicity, this is a critical point to keep in mind. Just like norms (or substantive inputs in a firm's culture), incentives (or tools for constructing that culture and translating it into observable conduct) emerge in response to different forces and operate on different levels, both internal and external to the firm. Accordingly, analyzing individual firms' internally constructed incentive structures is not likely to yield a fully satisfactory causal explanation of the pervasive ethical dysfunction in modern finance. A deeper understanding of this phenomenon necessarily requires examining the broader system of institutional incentives in which financial firms and professionals operate—and in which all of the entity-level incentive systems are actively immersed.

D. *The Culture of Finance as a Matryoshka Doll?*

To expand this last point, a deeper understanding of modern finance as a cultural phenomenon requires an explicitly and comprehensively systemic, macro-structural lens.

Functionally, the multi-layered culture of finance may be best described by analogy to a traditional Russian nesting doll, or Matryoshka. In discussing ethical conduct in finance, we ultimately seek to alter norms driving socially harmful behavior of individual bankers and traders. Individual financial professionals, however, are nested inside financial services firms whose organizational cultures determine much of their risk-taking behavior. Individual firms, in turn, operate inside a specific market or industry, and their cultures reflect the incentives and norms generated in those markets or industry sectors. Various financial markets and industry sectors operate within the financial system, which is itself nested inside the broader economic system it is supposed to serve. Finally, the economy operates inside the polity, and the basic norms underlying its operation reflect certain political—i.e., inherently normative—choices.

Tracing the path of norms and incentives from the outermost layer of the political system all the way down to the innermost level of an individual banker or trader—the smallest piece hidden deep inside the giant nesting doll—may seem like a daunting exercise. Of course, the task of fundamentally altering the currently pervasively "other-disregarding" culture of the financial services sector is itself inherently daunting. Yet, numerous scholars working in various academic disciplines continue to focus on that task, seemingly undaunted by its enormity. In this context, the complexity of the analysis required in order to understand

the Matryoshka-like cultural ecosystem of finance is hardly a compelling reason not to undertake it.

In fact, the lack of a deliberately systemic, macro-structural approach to analyzing the nature and sources of the dysfunctional culture in the financial sector is one of the principal factors limiting the ability of the current academic debate to generate a truly effective and comprehensive remedy for this dysfunction. While important and insightful, the current discussion of the culture of risk-taking in modern finance still implicitly operates within the familiar confines of an inherently micro-focused "bad apples" metaphor, even though the spotlight is now on the organizational "barrels" in which individual "apples" tend to go "bad" in such an alarming fashion.

III. "BETTER BARRELS, BETTER APPLES"? THE CURRENT DEBATE AND ITS LIMITS

Given the pervasive nature of cultural and ethical factors in human life, it is not surprising to see a large and diverse body of scholarly analysis and research in this area. Economists, organizational theorists, psychologists, anthropologists, sociologists, ethnographers, historians, and legal scholars continue to grapple with various aspects of the fluid and contextually thick concept of "culture." In this Part, I will focus on a narrow subset of this scholarship that targets specifically the cultural bias of financial services firms and professionals in favor of socially excessive, yet privately profitable, risk-taking. Furthermore, instead of attempting to provide a comprehensive review of this literature, my goal is to identify (1) the principal themes emerging in the debate on the dysfunctional culture of modern finance, and (2) the fundamental weaknesses in the currently proposed approaches to reforming that culture.

Thematically, the scholarly literature on the role of ethical and cultural factors in excessive generation and accumulation of systemic financial risk may be divided into three broadly drawn categories: descriptive and empirical analyses of the prevailing ethical and cultural norms in the financial sector; economic theories of organizational culture as a business input; and public policy-driven accounts of the legal and institutional mechanisms of cultural change in the financial sector. By shifting the focus away from individual misconduct as a mere "bad apples" problem to the broader corporate dynamics—or, to extend the metaphor, the quality of organizational "apple barrels"—this literature offers important insights into various aspects of this complex phenomenon. The same entity-level analytical focus, however, also significantly hinders the search for effective practical solutions to cultural problems in the financial sector.

A. *The Culture of Finance as a Social Phenomenon*

The first category of scholarly literature relevant to the present discussion is primarily diagnostic in its focus on identifying and explaining certain socially undesirable aspects of the financial sector ethics and culture. In recent years, there has been an increased interest among social scientists in unraveling and decoding the many hidden layers of cultural meanings and interactions inside financial institutions.[55] One of the best-known examples of this literature is Karen Ho's recent ethnographic study of Wall Street, in which she dissects the inner workings of the investment banking culture.[56] Using extensive insider interviews, Ho demonstrates how investment banks' internal incentive system, based on high bonuses and job insecurity, shapes individual bankers' overly aggressive attitudes toward risk-taking in their dealings with clients and other business activities.[57] Her study shows how the highest-performing graduates of elite universities, attracted by the exceptionally high remuneration practices in the financial industry, get socialized into this inherently short-termist culture of "high risk, high reward," which is eventually translated into the highly volatile boom-and-bust dynamics in modern financial markets.[58]

B. *Culture as a Business Input*

The second category of scholarship, by contrast, focuses on the role of corporate culture as a determinant of financial firms' business performance. Not surprisingly, this group is dominated by economists and organizational theorists. Economists, in particular, use the conceptual apparatus of microeconomics and organizational behavior studies to identify the mechanisms through which a financial firm's adoption of ethical business practices and explicitly other-regarding cultural norms enhances the firm's economic returns and organizational efficiency.[59] In these

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[55] *See, e.g.*, KAREN HO, LIQUIDATED: AN ETHNOGRAPHY OF WALL STREET (2008); Annelise Riles, *Market Collaboration: Finance, Culture, and Ethnography After Neoliberalism,* 115 AM. ANTHROPOLOGIST 555, 557–58 (2013) (examining cultural attitudes of Japanese bankers in the post-crisis period); Alain Cohn et al., *Business Culture and Dishonesty in the Banking Industry*, NATURE 1 (2014). For a detailed discussion of social science research on culture, see generally Gordon & Zaring, *supra* note 40.

[56] HO, *supra* note 55.

[57] *Id.*

[58] *Id.* Along somewhat similar lines, various experimental studies show persistent psychological bias among financial industry professionals toward more overtly selfish and dishonest behavior and excessive risk-taking. *See, e.g.*, C. W. Smith, *Financial Edgework: Trading in Market Currents*, in EDGEWORK: THE SOCIOLOGY OF RISK TAKING (Stephen Lyng ed., 2005); Alain Cohn, Ernst Fehr & Michel André Maréchal, *Business Culture and Dishonesty in the Banking Industry*, NATURE 516, No. 7569, 86 (2014).

[59] This literature is too vast to be cited in full here. For a sample of recent examples, see O'Toole & Bennis, *supra* note 2; Anjan Thakor, *Corporate Culture in Banking*, FRBNY ECON. POL'Y REV. 5, 8 (Aug. 2016); Werner H. Erhard, Michael C. Jensen & Steve Zaffron,

studies, ethical culture is analyzed in instrumental terms, as part of a private firm's business strategy and an objectively measurable input in its internal risk management and business processes. Creating and maintaining the right kind of firm culture, accordingly, is recast as an internal managerial function, rather than a moral duty the firm owes to the outside world.[60] For example, greater transparency becomes important not so much because it is morally significant or publicly beneficial but because it enhances the quality of the firm's business decisions and facilitates its growth.[61]

From that angle, firm culture is conceptualized not as a fuzzy, subjective judgment-driven space filler but as a functionally cabined, positive phenomenon that is both malleable and controllable.[62] Anjan Thakor, for example, advocates the use of so-called Competing Values Framework, borrowed from the organizational behavior literature, and maps out four principal types of value-enhancing strategies and corresponding culture types: Clan (collaborative), Control (hierarchical), Market (competitive), and Adhocracy (innovative).[63] Under this approach, each individual firm's organizational culture can be both graphically diagnosed as a particular mix of these different value types and then changed through the use of such institutional levers as compensation and performance metrics.[64]

Andrew Lo takes this idea further by proposing to develop a quantitative model for measuring and tracking behavioral risks as the basis for managing and changing culture.[65] Lo posits that thoughtfully combining certain key elements—such as, e.g., human resources and social network data, regulatory survey results, and latest advances in psychological research and empirical modeling of fraud and malfeasance—enables the development of "an empirically based methodology for predicting individual and group behavior" as a "function of observable systematic and

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Integrity: A Positive Model that Incorporates the Normative Phenomena of Morality, Ethics, and Legality – Abridged, Harvard Business School NOM Working Paper No. 10-061 (1 Feb. 2016).

[60] *See, e.g.*, Thakor, *supra* note 59, at 8 ("The culture of the organization must support the execution of the organization's growth strategy.").

[61] *See generally* O'Toole & Bennis, *supra* note 2 (arguing that candor improves performance).

[62] Michael Jensen and his co-authors go as far as replacing inherently "soft" concepts of morality and culture with a limited, technically defined concept of "integrity." *See* Erhard et al., *supra* note 59.

[63] *See* Thakor, *supra* note 59, at 9–10.

[64] Thakor identifies four key levers of cultural change: performance metrics, employee compensation, decision-making and resource allocation procedures, and behaviors to be rewarded or punished. *Id.* at 12–13.

[65] *See* Andrew W. Lo, *The Gordon Gekko Effect: The Role of Culture in the Financial Industry*, FRBNY ECON. POL'Y REV. 17, 35–36 (Aug. 2016).

idiosyncratic factors."[66] Robust predictive modeling of each individual employee's risk appetite, for example, would yield a reliable quantitative definition of the firm's overall risk culture.[67] According to Lo, once the behavioral patterns, values, and goals are identified and measured, the firm would be able to target specific changes in its risk-taking culture more effectively.[68]

These are just select—but highly representative—examples of economists seeking to transform the study of culture and its production into simply another branch of the established "science" of risk management within the business firm.[69] The apparent pragmatism and rigor (at least, in aspirational terms) of this approach to reforming culture explain its seductive appeal beyond the disciplinary boundaries of economics. Notably, financial regulators successfully incorporated it into their rhetoric by emphasizing that "good culture" is in financial firms' economic self-interest.[70] The warm glow of a straightforward and undisruptive "win-win" solution to a complex problem is a powerful thing.

The difficulty, though, is explaining why it remains so stubbornly elusive in practice.

C. *Culture as Institutional Governance*

The third category of academic writings on the ethics and culture in the financial sector focuses not on firms' internal economic calculus but on the legal and institutional mechanisms for bringing their organizational risk culture in line with the broader public interest and public policy. Not surprisingly, most legal scholars interested in the culture of finance find themselves in this thematic camp.

A significant portion of legal scholarship in this area is largely descriptive or expositional in character, as experts in various areas of law—

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[66] *Id.* at 37.

[67] *See id.* at 36–37.

[68] *Id.* at 38. As Lo concludes,

> [C]ulture can be a choice, not a fixed constraint. The emerging discipline of behavioral risk management can be means by which a corporation's culture is measured and managed. And, thanks to advances in the behavioral and social sciences, big data, and human resources management, for the first time in regulatory history, we have the intellectual means to construct behavioral risk models. We just need the will to do so.

[69] While acknowledging the importance of cultivating "a sense of higher purpose" for financial services firms, this scholarship is generally averse to veering too far from the firm's business goals. Financial firms' "higher purpose" is often defined quite modestly as helping their clients manage their money or achieve their financial goals. *See* Thakor, *supra* note 59, at 13–14.

[70] *See, e.g.*, William C. Dudley, President and Chief Exec. of the Fed. Reserve Bank of N.Y., *Reforming Culture for the Long Term*, at the Banking Standards Board, London, U.K. (Mar. 20, 2017), (transcript available at https://www.newyorkfed.org/newsevents/speeches/2017/dud170321).

banking, securities, corporate, etc.—attempt to analyze and place the post-crisis regulatory "ethics turn" in a broader doctrinal or normative context.[71] It is a valuable exercise, as it helps to ground regulators' vague calls for "more ethical" culture and conduct in institutional realities. It elucidates how the presently growing interest in these inherently "soft" factors potentially interacts with the ongoing efforts to reinforce the existing "hard" law governing financial institutions.[72]

While it is difficult to distill a single substantive thread in these discussions, most scholars appear to be cautious, if not outright skeptical, about regulators' practical ability to channel the financial industry's energy into tempering its appetite for high risk and high return.[73] The apparent contrast between traditional methods of curbing financial firms' risk-taking through formal regulation and supervision, on the one hand, and the increasing salience of moral suasion as part of regulators' toolkit, on the other, has prompted academics to inquire "as to what it means to operationalize ethics and culture in a regulatory project."[74]

So far, however, this collective inquiry has produced little by way of a unified vision or theory. As a general matter, legal scholars advocate reforming the presently dysfunctional culture in the financial sector through incremental—and often complementary and mutually reinforcing—changes in financial firms' internal corporate governance and the external regulatory framework within which they operate. The focus is primarily on correcting the basic incentive structure within financial firms in ways designed to discourage socially undesirable risk-taking—and to do so through contractual (private ordering) and governmental (public regulation) means.

One specific measure, widely discussed and advocated as a potential solution to a whole range of problems in the financial sector, involves reforming the performance-based compensation structure within financial services firms.[75] Legal scholars generally agree that banks should avoid tying their employees' and executives' salaries and bonuses to banks' short-term profits—a potentially systemically destabilizing factor—and use more integrative measures of banks' long-term sustainability to incentivize bank employees and executives to act in a more

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[71] *See, e.g.*, Awrey et al., *supra* note 38, at 191; Gordon & Zaring, *supra* note 40, at 563.

[72] *See id.*; Christina Parajon Skinner, *Misconduct Risk,* 84 FORDHAM L. REV. 1559, 1561–63 (2016).

[73] *See, e.g.*, Gordon & Zaring, *supra* note 40, at 564–65.

[74] *Id.* at 559.

[75] *See, e.g.*, Lucian A. Bebchuk & Holger Spamann, *Regulating Bankers' Pay*, 98 GEO. L. J. 247, 249–53 (2010); John C. Coffee, Jr., *The Political Economy of Dodd-Frank: Why Financial Reform Tends to be Frustrated and Systemic Risk Perpetuated*, 97 CORNELL L. REV. 1019, 1047 (2012); CLAIRE A. HILL & RICHARD W. PAINTER, BETTER BANKERS, BETTER BANKS 160–61 (2015).

socially responsible manner. A system of compensation clawbacks, in particular, is commonly viewed as a potentially effective method of altering the monetary incentives of individual bankers and traders.[76]

The main weakness of these proposals is the inherent difficulty of ensuring that compensation limits and mandatory clawbacks actually help to reduce the level of systemic risk on the front end.[77] On the other hand, the beauty of a compensation-based reform is that it does not require regulatory intervention and aligns well with the basic tenets of corporate law and governance.[78] Claire Hill and Richard Painter, for example, propose that investment banks impose contractual obligations on their highly paid bankers to bear personal liability for some portion of their banks' losses from excessive risk-taking or violations of law.[79] This system of "covenant banking" would, Hill and Painter argue, force individual bankers to internalize the costs of their socially irresponsible actions and, consequently, to adopt a more conservative ex ante attitude toward financial and legal risk.[80]

Another approach to improving the ethical culture of finance seeks to incentivize financial firms' boards of directors to pay greater attention to their firms' culture, either by changing the board structure or by expanding directors' liability under fiduciary standards.[81] Thus, one suggestion is for every financial firm to establish a special ethics committee charged with setting specific ethical "outcomes," measuring the firm's processes for achieving such outcomes, and putting in place ethical disciplinary procedures.[82] Another proposed measure is to strengthen the judicial standard for the duty of care applicable to certain ethically or systemically salient decisions by firm directors.[83] And some scholars even advocate expanding the traditional scope of directors' and managers' fiduciary duties to hold them legally accountable to the firm—or various stakeholders that act as proxies for the firm or the public—for systemically destabilizing risk-taking.[84]

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[76] *See* HILL & PAINTER, *supra* note 75; Awrey et al., *supra* note 38, at 236; Skinner, *supra* note 72, at 1603–04.

[77] *See* Awrey *et al., supra* note 38, at 234–38.

[78] Thus, aligning compensation with the corporation's and its shareholders' long-term interests is seen as a way of solving the agency problem, the central preoccupation of the mainstream corporate law theory. *See* Bebchuk & Spamann, *supra* note 75, at 257, 269.

[79] *See* HILL & PAINTER, *supra* note 75, at 177–78.

[80] Hill and Painter argue that this forward-looking, *ex ante* nature of incentives renders their proposed covenant banking a more effective option than proposals to limit the amount of executive compensation. *Id.* at 178–79.

[81] *See* Awrey et al., *supra* note 38, at 232–34.

[82] *Id.* at 234.

[83] *Id.* at 242–44.

[84] *See, e.g.*, John Armour & Jeffrey N. Gordon, *Systemic Harms and Shareholder Value*, 6 J. LEGAL ANALYSIS 35, 50 (2014); Steven L. Schwarcz, *Controlling Systemic Risk Through*

Expanding the concept of fiduciary duty beyond its traditional boundaries, however, creates numerous doctrinal and practical difficulties.[85] It is also prone to criticism as a judicial enforcement mechanism likely to "crowd out" potential organic improvements in a financial firm's culture.[86] In that sense, tinkering with directors' fiduciary duties is likely to be less effective in practice than overt regulation and supervision. Building on this intuition, Christina Skinner proposes expanding the practice of mandatory stress testing of systemically important financial institutions to include so-called "compliance stress tests," which would involve misconduct simulation exercises and supervisory review of each firm's "compliance plans."[87] This scheme would effectively seek to repurpose the basic techniques of quantitative supervisory tests of banks' capital and liquidity positions—both crucial financial metrics—for qualitative testing of the strength of their regulatory compliance function.[88] It is, of course, unclear how amenable to such qualitative repurposing the existing supervisory stress-testing toolkit would be in practice.

Another group of legal scholars is looking for more subtle, collaborative methods to improve the culture in the financial sector, which explicitly combine private ordering with public regulation. For example, Dan Awrey, William Blair and David Kershaw "examine how 'process-oriented' regulation, backed by a credible threat of both public enforcement and reputational sanctions, might be employed with a view to reframing personal ethical choices and fostering a more ethical organizational culture within financial services firms."[89] They use the UK's regulatory initiative, Treating Customers Fairly (TCF), as the model of such a process-oriented strategy that can be extended from the area of retail consumer and investor protection to wholesale financial markets and systemic risk prevention.[90] As Awrey and his co-authors emphasize, this model seeks to foster more effective compliance with the principles of ethical conduct not through compulsion but through meaningful engagement with desired regulatory outcomes: it is the process of dialogue, implementation, self-assessment, and dissemination of knowl-

Corporate Governance, CIGI Policy Brief No. 99 1, 2 (Feb. 2017), https://papers.ssrn.com/sol3/papers.cfm?abstract_id=2933045.

85 For an analysis of such difficulties, *see generally* Robert C. Hockett, *Are Bank Fiduciaries Special*? 68 ALA. L. REV. 1071 (2017).

86 *See, e.g.*, Steven M. Davidoff, Alan D. Morrison, William J. Wilhelm, Jr., *The SEC v. Goldman Sachs: Reputation, Trust, and Fiduciary Duties in Investment Banking*, 37 J. CORP. L. 529, 530–33 (2012) (arguing that expanding fiduciary duty standards in investment banking might harm banks' reputational incentives to behave in a trustworthy manner).

87 Skinner, *supra* note 72, at 1600–01.

88 *Id.* at 1600.

89 Awrey et al., *supra* note 38, at 191.

90 *Id.* at 196.

edge that ultimately produces a more ethical culture within the firm.[91] Importantly, however, the key to success of this approach is a credible threat of external regulatory enforcement, not only with respect to outcomes but also with respect to process.[92]

While sharing this fundamental appreciation of the broader institutional context in which firms operate, Cynthia Williams and John Conley place a greater emphasis on "soft law" and "new governance" methods directly complementary to self-regulation.[93] Drawing inspiration from various private initiatives to embrace corporate social responsibility, Williams and Conley propose changing accounting standards and requiring financial institutions to provide "social risk disclosure."[94] Under their proposed system of integrated accounting, large financial firms would be required to report their "financial, social, environmental, and governance information."[95] In order to meet these integrated reporting requirements, financial firms would have to engage in regular data-gathering and self-reflective analysis of their contribution to long-term social value-creation – which, in turn, would drive an organic change in their internal culture and ethical climate.[96]

D. *The Limits of the Current Debate*

In sum, the current debate on the causes of and remedies for the currently pervasive ethical problems in the financial industry spans many an academic discipline—sociology, anthropology, economics, and law, just to name a few—and encompasses different approaches to culture as a social phenomenon, a business input, or a product of legal and institutional choices. While a brief overview of this literature, attempted above, cannot present an in-depth analysis of all relevant scholarship, it enables us to make a few important observations on the scope, framing, and other defining features of the public debate.

First of all, the principal focus of academic and policy discussions is on an individual financial services firm. A single financial firm—a discrete corporate entity—remains the key unit of descriptive analysis and the primary target of prescriptive proposals on reforming culture in the financial sector. Individual human beings and their ethical choices are examined and evaluated within the context of, and through the prism of

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[91] *Id.* at 221–25.

[92] *Id.* at 226.

[93] Cynthia A. Williams & John M. Conley, *The Social Reform of Banking*, 39 J. CORP. L. 459, 473–74 (2014).

[94] *Id.*, at 484.

[95] *Id.* at 487.

[96] *Id.* at 488.

their functional roles, in the firm.[97] External institutional arrangements and norms—those at the level of the financial services industry, broader market economy, or society at large—are typically considered only to the extent they affect, or are mediated through, the firm's internal cultural dynamics.

Furthermore, the main target of scholarly efforts to diagnose and correct the existing risk culture within financial services firms is the structure of organizational incentives—monetary, disciplinary, or reputational—that encourage or discourage potentially excessive levels of risk-taking by individual firm employees and managers. The most commonly discussed categories of entity-level incentives include compensation practices (and related performance metrics) and organizational accountability structures (including the assignment of legal duties and liabilities).[98]

Finally, underlying the academic and policy debate is a general normative preference for a "win-win" solution to the problem of "bad conduct" and excessive risk-taking in the financial sector. An unspoken assumption that private firms' economic interests can, and should, be fully aligned with the public interest in preserving financial stability subtly, but forcefully, sets the key normative parameters within which the discussions take place. It also determines the range of acceptable reform choices. Thus, commonly discussed measures for improving the ethical culture of financial firms implicitly incorporate—and often explicitly appeal to—the prevailing ideological attitudes and values of self-interest and individualism.[99] The concrete reform measures are deliberately framed as incremental changes to the existing legal and institutional arrangements, as such arrangements operate at the individual firm level, rather than a radical rewiring of the financial system's architecture.[100]

Many of these proposed reform measures are potentially useful and socially desirable. There is no doubt, for example, that financial firms' compensation practices and internal governance mechanisms should be

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[97] This isn't to say that scholars are not interested in understanding and reshaping individual ethics and conduct. For example, Hill and Painter explicitly focus on individual bankers' moral choices and seek to alter their conduct, but see certain firm-level changes as the most effective method of doing so. *See supra* notes 79–80 and accompanying text.

[98] As discussed above, some reform proposals more explicitly incorporate certain external factors, such as regulatory regime changes or changes in the industry's accounting standards, as important drivers of the risk-taming cultural changes within the financial sector. *See supra* notes 89–96 and accompanying text. Nevertheless, even these proposals generally view such external factors as simply anchoring and facilitating the cultural shift at the level of individual firms, which remain the primary intended site of reform.

[99] *See supra* Part III.B–C.

[100] In this respect, the debate on the ethics and culture of finance is fundamentally similar to, and significantly overlaps with, the broader debate on the role of financial firms' corporate governance as a tool of systemic risk prevention. For a small sample, see sources cited *supra* notes 84–86.

changed in ways that reduce incentives for the firms and their employees to act unethically or destabilize the financial system. The devil, however, is in the details of designing and implementing this change in practice. And the most important detail of all is how to ensure that every financial institution—a private firm legitimately pursuing private profits—adopts and faithfully implements socially beneficial compensation or governance practices, despite the fact that doing so is likely to reduce its profitability and competitive strength. What would it take for a privately-owned firm to resist the all-powerful gravitational pull of private profit-generation for the sake of some generalized public good?

This fundamental tension between the legitimate pursuit of economic self-interest by private entities, on the one hand, and the public interest in preventing systemic harms, on the other, remains unresolved in the current intellectual debate on the culture of finance. Oscillating between abstract aspirations and incremental fixes, the debate lacks an overarching theory of how to make financial firms' internal cultures significantly more other-regarding and socially responsible. Despite many academics' valiant and valuable efforts, we do not yet have a satisfactory strategy for resolving "the critical issue of our time: how can the genius of finance be channeled for positive social development rather than being used solely for private gain at any social cost?"[101]

To resolve this issue, we need to shift our collective thinking on the risk culture in the financial sector onto a higher, more systemic plane – and look for more effective solutions outside the limiting scope of the present debate. Of course, moving away from blaming the widespread ethical problems in the financial sector on individual "bad apples" within organizations to examining the soundness of organizational "apple barrels" is an important step toward a better understanding of such problems. But is it possible to improve the quality of individual firms' risk cultures without understanding—and acting upon—the broader context in which these firms do business, market conditions to which they have to adjust, and external incentives which shape their choices?

IV. TOWARD SYSTEMIC SOLUTIONS: A MACRO-STRUCTURAL APPROACH TO IMPROVING CULTURE IN THE FINANCIAL INDUSTRY

The traditional Russian nesting doll, or Matryoshka, provides a helpful metaphor for visualizing the broader cultural dynamics in the financial services sector as a multi-layered, systemic phenomenon.[102] The existing literature focuses on two innermost layers of the system: the

[101] *See* Williams & Conley, *supra* note 93, at 486.

[102] *See supra* Part II.D.

individual and the firm within which that individual is "contained." There is an important logic to this broadening of the initial focus on individual misbehavior as a mere "bad apple" problem to include the broader organizational dynamics. People will always make unethical but personally advantageous choices if their immediate environment—the organizational "container"—either actively rewards or passively tolerates that behavior.

An "apple barrel" is an obvious metaphor for the organizational context in which human "bad apples" exist.[103] It does not, however, lend itself easily to further enlargement of the analytical focus beyond the organizational limits of a single firm. Yet, the latter is a necessary step in our quest for understanding firm-level cultural dynamics: in real life, a single firm is less like a self-contained barrel than a doll nested inside the multi-doll Matryoshka system. Each doll inside that system may stand on its own and sport a distinctive color and pattern, but its basic shape and function are determined by reference to the organically interdependent whole. It is this fundamental macro-structural unity that makes a colorful wooden souvenir brought from foreign travels a helpful conceptual representation of today's financial universe.

In this Part, I will attempt to unpack this unconventional metaphor and show how improving the presently dysfunctional risk culture of financial services firms requires a deep rethinking of, and changes in, the basic structure and dynamics of the entire financial system – and, ultimately, the broader normative framework within which it operates.

A. *Firms in Institutional Context*

As argued above, firms do not construct their organizational culture purely from the ground up, as a combined product of their individual employees' or managers' ethical values and attitudes.[104] A critically important source of firms' internal systems of norms, incentives, and behavioral patterns is the market in which these firms compete and the industry which they collectively compose. Individual firms are not free agents exercising their morally salient organizational choices in a vacuum; they are interconnected elements of a bigger whole—the market, the industry, the system—and their individual choices and strategies reflect certain fundamentally collective choices and strategies. A financial services firm continuously absorbs, processes, operationalizes, and hierarchically orders a multitude of norms, expectations, and incentives generated within the relevant market and the financial services industry as a whole. Therefore, in order to understand—and, more importantly, to in-

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[103] *See* O'Toole & Bennis, *supra* note 2, at 4.

[104] *See supra* Part II.

fluence—the process of continuous production of shared norms, beliefs, and attitudes toward risk-taking inside any individual financial services firm, it is critical to understand the basic structure and operation of the financial market, more generally.

A full analysis of the structure and operation of modern financial market is beyond the scope of this Article. For present purposes, the key is to focus on the fundamental market dynamics that currently hinder the emergence of a viable, internally sustained, other-regarding culture of risk-taking in the financial services sector.

Let us start with the basics. The regulatory campaign to push financial services firms toward embracing more socially responsible norms of prudent risk-taking and systemically beneficial self-restraint can succeed only to the extent such a shift does not threaten an individual firm's ability to thrive in the existing business environment. It will simply not be rational for a single firm to change its behavior and internal incentive structure in ways that would diminish its competitive strength vis-à-vis other firms in the market. Calling for this kind of unilateral disarmament, even for the sake of improving the firm's organizational efficiency and long-term performance potential, is not likely to yield practical results.[105] Even appealing to firms' economic self-interest, though arguably more effective than appealing to abstract moral values, is not likely to deliver the desired results in practice if it is focused primarily on what happens within a single firm.[106]

Of course, the idea behind this campaign—and academic proposals—is to make all, or at least the critical mass of, financial services firms to disarm simultaneously. Implicitly, it is assumed that what appeals to a single firm would be adopted independently and voluntarily by every single firm, and that would automatically change the culture of the industry as a whole. This, however, is a common fallacy of composition. It ignores the fact that the whole is a product of complex interaction among its constitutive elements and, therefore, is qualitatively different from any individual element within it.[107] While it is true that changing

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[105] *See* Robert Hockett, *Recursive Collective Action Problems: The Structure of Procyclicality in Financial and Monetary Markets, Macroeconomies, and Formally Similar Contexts*, 3 J. FIN. PERSP. 1, 10–12 (2015) [hereinafter, "*Recursive Collective Action Problems*"] (using arms races and unilateral disarmament as classic examples that help to explain a broad range of individually rational but collectively irrational dynamics in financial markets).

[106] For a discussion of how pervasive appealing to individual firms' self-interest is in the current discourse on risk culture in the financial sector, see *supra* Part III.B.

[107] The fallacy of composition is a concept rooted in the classic Aristotelian categorization of logical errors. For a helpful overview, *see generally* Hans Hansen, STANFORD ENCYCLOPEDIA OF PHILOSOPHY, Fallacies (Edward N. Zalta) (Fall 2017), https://plato.stanford.edu/entries/fallacies/#Ari. For a specific application of this concept to finance, see *Bubbles, Busts, and Blame, supra* note 14, at 17 (arguing that to assume that asset price bubbles are incompatible with individual rationality is to commit a fallacy of composition). For a more comprehen-

the culture of the financial services industry requires changing the culture of the firms it comprises, the opposite is equally true. The latter cannot be separated from the former.

In fact, as I have argued elsewhere, changing the prevailing industry-wide practices and attitudes toward systemically destabilizing risk-taking is the key prerequisite for the firm-level cultural change.[108] The million—or, perhaps more accurately, multi-trillion—dollar question is, how to ensure the organic, endogenous development of such a new industry culture, or industry morality, in the realm of finance.

B. From Endogenous to Exogenous: Industry Morality and Structural Reform

The term "industry morality" denotes "a set of commonly accepted industry-wide principles and practices that defines right conduct as it spells out the industry's public commitment to moral restraint and aspiration."[109] It is a potentially powerful mechanism for re-orienting private firms' business conduct toward goals other than their narrow economic self-interest, such as the goal of preserving and enhancing systemic financial stability. A shared normative framework holding all industry participants to the same standard of other-regarding behavior would function as a universal disarmament pact, enabling individual firms to align their internal incentive structures with the public's interest in minimizing systemic financial risk.[110]

Admittedly, there are few real-life examples of such other-regarding industry morality successfully curbing undesirable externalization of risk by profit-seeking private firms. Social scientists, for example, examined the rise of consciously public risk-driven self-regulation schemes in the nuclear energy and chemical manufacturing industries.[111] Whether these industries succeeded in achieving that laudable goal is a matter of con-

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sive theoretical and historically-grounded post-crisis account of the importance of structural, as opposed to individual or firm, incentives for financial risk-taking, *see generally* Robert Hockett, *A Fixer-Upper for Finance,* 87 WASH. U. L. REV. 1213 (2010); *Bretton Woods 1.0: A Constructive Retrieval for Sustainable Finance*, 16 N.Y.U. J. LEG. & PUB. POL'Y 401 (2013) [hereinafter, *"Bretton Woods 1.0"*]; and *Recursive Collective Action Problems, supra* note 105.

[108] *See* Saule T. Omarova, *Wall Street as Community of Fate: Toward Financial Industry Self-Regulation*, 159 U. PA. L. REV. 411, 431–38 (2011) [hereinafter, *"Wall Street as Community of Fate"*].

[109] Neil Gunningham & Joseph Rees, *Industry Self-Regulation: An Institutional Perspective*, 19 LAW & POL'Y 363, 376 (1997).

[110] *See supra* note 105 and accompanying text.

[111] *See Wall Street as Community of Fate, supra* note 108, at 442–55 (describing the key findings and criticisms of social science research on the nuclear energy and chemical manufacturing industries' efforts to protect the public from harm through industry-wide self-regulation).

siderable doubt.[112] For our purposes, however, the importance of these case studies is in understanding what factors make an industry—any industry—likely to take the critical first step toward that goal. What factors are likely to force an industry to recognize the need to overcome its short-term orientation and develop a new normative framework for conducting business in a more publicly beneficial manner?

Of course, there is no simple answer to this question: each industry's experience is uniquely complex and difficult to distill down to a general recipe. Nevertheless, at the most basic level, the nuclear energy and chemical manufacturing sectors' experiences reveal a critical causal link. They show that the most powerful incentive for a private industry to change its shared code of conduct is not some kind of mass moral revelation: it is the fear of regulatory shutdown in response to a politically salient failure of the industry to protect the public from harmful consequences of its privately profitable activities.[113] In that sense, the rise of an industry morality overtly proclaiming the industry's commitment to protect innocent third parties from harm was a matter of pragmatic self-preservation.

For example, the project of developing an explicitly public safety-oriented self-regulatory regime in the U.S. nuclear power sector began after the Three Mile Island incident in 1979, which made it face an existential threat of being shut down by the government.[114] Despite its negligible impact on the environment or health of people outside the plant, the incident caused a great deal of public outrage and fear, which in turn put a lot of pressure on the federal government to protect the public by banning commercial nuclear power production.[115] Nuclear power companies' prohibitively high cost of physically relocating their operations to a different jurisdiction made their perception of vulnerability particularly acute. While a number of other factors—the degree of the industry's homogeneity, the ability of public interest groups to exert pressure on the industry, or the existence of a strong industry leadership—played a role in shaping this push to develop an industry morality in the nuclear power sector, the undeniable key driver behind it was the threat of governmental prohibition of nuclear power production.[116] A fundamentally similar

[112] *See id.*

[113] *See id.*

[114] *See generally* JOSEPH REES, HOSTAGES OF EACH OTHER: THE TRANSFORMATION OF NUCLEAR SAFETY SINCE THREE MILE ISLAND (1994).

[115] *See* United States Nuclear Regulatory Commission, Backgrounder on the Three Mile Island Incident, https://www.nrc.gov/reading-rm/doc-collections/fact-sheets/3mile-isle.html#effects.

[116] *See Wall Street as Community of Fate*, *supra* note 108, at 454.

story unfolded in the chemical manufacturing sector in the wake of the 1984 Bhopal disaster that claimed thousands of lives.[117]

The financial services industry, which has survived a truly global systemic crisis, is unlikely to develop a similar sense of existential threat. The events of 2008-2009 illustrate the degree to which the largest, most complex financial institutions, responsible for generating the highest risks to systemic stability, are not only immune to government retaliation—they are immune to failure precisely because the government will not let them fail. In effect, systemically important financial firms are "too big to fail" (TBTF).[118] A vast body of scholarly and popular literature is devoted to examining the causes of, and the cures for, the TBTF phenomenon and the moral hazard it creates.[119] For purposes of the present discussion, however, the key is to elucidate the intimate link between the goal of encouraging the emergence of a systemic risk-conscious "industry morality" in the financial sector, on the one hand, and the need to address the structural aspects of TBTF, on the other.[120]

In other words, understanding the dynamics of an industry-wide normative shift of the type needed to enable individual firms to change their internal organizational norms and incentives—away from the powerful goal of maximizing short-term profitability and toward a more diffuse notion of safeguarding systemic stability—reveals the central importance of structural reform in the financial services sector.[121]

The range of potential options for such reform includes, for example, breaking up TBTF financial conglomerates into smaller, more specialized firms and imposing a size limit on financial institutions, in the spirit of the traditional antitrust regulation.[122] A complementary, though conceptually distinct, measure is structural separation of the financial

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[117] *Id.* at 449–50.

[118] The term "too big to fail" was originally used to refer to Continental Illinois National Bank and Trust Company, whose near-failure in 1984 threatened the stability of the U.S. banking industry. *See* History of the 80's—Lessons for the Future, 235–57 (vol. 1, 1997), *available at* https://www.fdic.gov/bank/historical/history/235_258.pdf.

[119] The post-crisis literature on the TBTF phenomenon is too vast and diverse to cite here, especially since the concept is used in a wide variety of contexts and for a multitude of reasons. For a popularly written book-length account of how this phenomenon manifested itself during the recent financial crisis, *see generally* ANDREW ROSS SORKIN, TOO BIG TO FAIL (2010).

[120] Thus, Professor Mark Roe persuasively argues that being TBTF corrupts financial firms' corporate governance and organizational culture and incentivizes them to seek to abuse the public subsidy rather than serve the real economy. Mark J. Roe, *Structural Corporate Degradation Due to Too-Big-To-Fail Finance*, 162 U. PENN. L. REV. 1419 (2014).

[121] For an overview of the post-crisis attempts at structural reform in the financial sector, see Saule T. Omarova, *Central Banks, Systemic Risk, and Financial Sector Structural Reform,* in RESEARCH HANDBOOK ON CENTRAL BANKING (Rosa Lastra and Peter Conti-Brown, eds.) (forthcoming 2018) [hereinafter, "*Central Banks, Systemic Risk*"].

[122] *See, e.g.*, Jonathan R. Macey & James P. Holdcroft, Jr., *Failure is an Option: An Ersatz-Antitrust Approach to Financial Regulation*, 120 YALE L.J. 1368 (2011); SIMON JOHN-

services industry along various activity or product lines. While the most commonly discussed versions of this approach include institutional separation of federally-insured deposit-taking from either investment banking[123] or lending[124] businesses, it is possible to envision other criteria for redrawing regulatory boundaries.[125]

In essence, these measures seek to restrain and condition firms' entry into specific markets for financial products and services, and to limit both (1) the size and the range of permissible business activities of individual firms, and (2) the scope and distortive impact of public subsidy of certain financial institutions. Both of these outcomes are designed to decrease the likelihood of individual firms pursuing socially harmful high-stakes, high-risk business strategies.[126] Smaller, more specialized financial services firms are less likely to incur or create leverage and risk at systemically unsustainable levels. Unlike mega-sized financial conglomerates, these smaller firms are not presumptively shielded from bankruptcy and are, therefore, more directly subject to healthy market discipline. As a result, they are more likely to base their business strategies on relational and reputational factors, which fosters a more client- and customer-oriented, less short-term risk-driven culture.[127] Put simply, once no individual firm is "too big to fail," the industry as a whole is far more likely to embrace collective self-restraint as a long-term survival imperative.[128]

SON & JAMES KWAK, THIRTEEN BANKERS: THE WALL STREET TAKEOVER AND THE NEXT FINANCIAL MELTDOWN (2010).

[123] *See* Banking Act of 1933 (Glass-Steagall Act), Pub. L. No. 73-66, 48 Stat. 162 (codified as amended in scattered sections of 12 U.S.C.), *repealed in part by* Financial Services Modernization Act of 1999 (Gramm-Leach-Bliley Act), Pub. L. No. 106-102, 113 Stat. 1338 (codified in scattered sections of 12 and 15 U.S.C.).

[124] *See, e.g.*, LAWRENCE KOTLIKOFF, JIMMY STEWART IS DEAD: ENDING THE WORLD'S ONGOING FINANCIAL PLAGUE WITH LIMITED PURPOSE BANKING (2011)*;* Adam Levitin, *Safe Banking*, 83 U. CHI. L. REV. 357, 357 (2016); George Pennacchi, *Narrow Banking*, 4 ANN. REV. OF FIN. ECON. 1 (2012); Arthur J. Wilmarth, *Narrow Banking: An Overdue Reform that Could Solve the Too-Big-to-Fail Problem and Align U.S. and U.K. Regulation of Financial Conglomerates*, 31 BANKING & FIN. SERV. POL'Y REP. 1 (2012).

[125] *See, e.g.*, *Wall Street as Community of Fate*, *supra* note 108, at 476–82. *See also Central Banks, Systemic Risk*, *supra* note 121.

[126] On the heightened propensity of large, diversified financial conglomerates to pursue such high-risk, high return business strategies, *see, e.g*. Arthur E. Wilmarth, Jr., *The Dark Side of Universal Banking: Financial Conglomerates and the Origins of the Subprime Financial Crisis*, 41 CONN. L. REV. 963, 964 (2009).

[127] In fact, scholars writing on the ethics and culture of finance often recognize this general link between the industry's structure and its culture. *See, e.g.*, Thakor, *supra* note 59, at 13 (arguing that older, smaller banks have a stronger internal culture); Davidoff et al*., supra* note 86, at 533 (stating that traditional, specialized investment banks pursued a relational business model based on their reputational capital). *See also* ALAN D. MORRISON & WILLIAM J. WILHELM, INVESTMENT BANKING: INSTITUTIONS, POLITICS, AND LAW (2007).

[128] *See* Roe, *supra* note 120, at 1460; *see also* Davidoff et al*., supra* note 86, at 533.

The key point here is not to advocate any specific proposal on its merits but to outline the types of potential changes in the immediate institutional context in which individual financial services firms operate, which would make such firms more likely to cultivate a more prudent and socially responsible risk-taking culture. Any potential structural reform measure is bound to raise numerous objections, especially from the financial industry, and face numerous design and implementation challenges.[129] From the perspective of cultural change, however, the ultimate problem is that these reforms involve explicit government regulation, an inherently exogenous factor vis-à-vis the culture of the firm. Just like with every regulatory attempt to control private risk-taking in the financial sector, these reforms will inevitably encounter resistance and hostility from the financial services firms well-versed in the art of regulatory arbitrage.[130] As a result of these familiar dynamics, drawing formal legal and regulatory lines may potentially have a perverse practical effect of creating even more destabilizing complexity and hidden risk in the financial system.[131]

To avoid that counterproductive outcome, it is important that private financial institutions are somehow co-opted into accepting the reforms likely to hurt their profitability. In other words, traditional top-down structural reform of the financial sector, necessary for the emergence of an industry-wide culture of prudent risk-taking, is itself unlikely to succeed without such a cultural shift.

This vicious "regulation-evasion" cycle is the key reason why private ordering is so often viewed as the most viable method of improving the financial firms' risk culture. However, casting available policy alternatives in this rigidly binary way ignores the existence of a critically important third choice on the menu of levers of cultural change: the use of public power to alter the key financial market dynamics from within, through direct participation in market transactions.

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[129] For a discussion of some of these challenges, see *Central Banks, Systemic Risk, supra* note 121.

[130] The literature on the nature and role of regulatory arbitrage in the financial services sector is too voluminous to cite here. The rise of today's derivatives and repo markets, and the growth of money market mutual funds, for example, were direct products of regulatory arbitrage and financial firms' desire to circumvent specific regulatory constraints on their activities. For a recent book-length account of these dynamics, see ERIK GERDING, LAW, BUBBLES, AND FINANCIAL REGULATION (2013).

[131] *See Central Banks, Systemic Risk, supra* note 121 (summarizing the arguments to this effect advanced by the opponents of structural reform in the financial sector).

C. *From Exogenous to Endogenous: Public Options and Market Dynamics*

As discussed above, regulatory restructuring of the financial industry can facilitate the emergence of a more public-minded risk culture—an industry-wide disarmament pact—only indirectly, through the industry actors' collective decision-making. This renders the entire process less transparent and more vulnerable to subversion by the hostile industry actors. But the government could also affect each financial services firm's risk-taking behavior—and, ultimately, attitudes—more directly, by taking on the role of a market participant. By acting endogenously, as a regular market actor, rather than exogenously, as a market regulator, the government can target the fundamental market dynamics much more effectively. It can also use its potentially transformative market-actor tools to supplant and support the more traditional, top-down structural reforms of the kind discussed above.

In previous work, my colleague Robert Hockett and I have argued that public instrumentalities are uniquely capable of performing a wide array of functions critical to the successful operation—and, indeed, very survival—of the ostensibly private financial markets.[132] Public instrumentalities' unique built-in advantages—large size, access to public funding, long-term investment horizon, legal and regulatory privileges—enable them to take on greater risk at times when no private market actor is able to do so.[133] In that sense, public instrumentalities are "natural" market contrarians whose presence is critical in order to resolve a particularly pernicious kind of the financial market dysfunction: recursive collective action problems.[134]

Financial markets are rife with recursive collective action problems.[135] Financial asset bubbles, fueled by short-term speculation and followed by devastating busts, exemplify this phenomenon. While it is individually rational for each firm to purchase assets during the bubble phase and sell them during the bust phase, these mutually reinforcing, individually rational decisions aggregate into collectively dysfunctional outcomes.[136] A vivid illustration of this pernicious dynamic comes from

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[132] For an in-depth treatment, including a taxonomy, of the government's market-actor roles, see Robert C. Hockett & Saule T. Omarova, *Public Actors in Private Markets: Toward a Developmental Finance State*, 93 WASH. U. L. REV. 103, 107 (2015) [hereinafter, *Public Actors*]; Robert C. Hockett & Saule T. Omarova, *"Private" Means to "Public" Ends: Governments as Market Actors*, 15 THEORETICAL INQUIRIES IN L. 53, 56 (2014).

[133] *See Public Actors*, *supra* note 132, at 138.

[134] *See Bretton Woods 1.0, supra* note 107, at 107 (introducing and explaining the term); and *Recursive Collective Action Problems, supra* note 105, at 10 (detailing the shared structure of all recursive collective action problems, demonstrating their ubiquity in financial markets, and outlining the common form shared by their solutions).

[135] *Recursive Collective Action Problems, supra* note 105, at 1.

[136] *See id.* at 17–22; *Bretton Woods 1.0, supra* note 107 at 420–25.

Charles Prince, then Citigroup's CEO, who famously compared the pre-crisis buildup of unsustainable risk and leverage in the financial sector to the game of musical chairs.[137] No single financial firm could "stop dancing" and exit that increasingly dangerous game until the entire game came to a halting stop in the fall of 2008, just one year after Prince's interview.[138]

This framework is helpful for understanding—and creatively overcoming—the challenge of improving financial firms' dysfunctional culture of risk-taking. If we accept that cultivating a more prudent, socially responsible, and systemically-oriented risk culture is in each firm's own long-term economic interest, then the fact that no single firm can afford to take this step unilaterally is a sign of serious collective irrationality. Avoiding this collective irrationality necessarily requires coherent collective agency, exercised counter-cyclically.[139] In practice, only public instrumentalities are well-positioned to perform this critical function.[140] Accordingly, the solution has to come from a public instrumentality, acting to correct specific market-generated incentives for firms to continue their collectively irrational behavior by making it also individually irrational.[141]

In other words, a truly meaningful and effective cultural shift in the financial sector requires creation and proactive use of what may be called "public options" in the financial marketplace. Without claiming to provide a detailed blueprint for action, it is possible to sketch out a general approach to creating such public options. The essence of this approach is deliberately using public instrumentalities to (1) target specific market dynamics, and (2) act in ways that would render systemically risky behavior no longer individually rational for any private market participant.

For example, a major source of socially excessive risk in the financial system is credit-fueled, short-term speculative trading in secondary markets. It is individually rational for private firms operating under short-term performance pressure to engage in such speculative trading, which creates socially destructive boom-bust financial cycles.[142] To

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137 Michiyo Nakamoto & David Wighton, *Citigroup Chief Stays Bullish on Buyouts*, FIN. TIMES (July 9, 2007), https://www.ft.com/content/80e2987a-2e50-11dc-821c-0000779fd2ac ("[A]s long as the music is playing, you've got to get up and dance. We're still dancing.").

138 *Id.*

139 *See Recursive Collective Action Problems*, *supra* note 105, at 23–32; *Public Actors*, *supra* note 132 at 129–31.

140 *See Recursive Collective Action Problems*, *supra* note 105, at 24 ("Where the collectivity in question is, or is part of, a polity or some other aggregate of persons in whom the attributes of sovereignty vest—that is, a state—the most common form of such agency is a government or government instrumentality. In a state or other polity, government is the collective agent par excellence.").

141 *See* sources cited *supra* note 139.

142 *Id. See also A Fixer-Upper for Finance, supra* note 107, at 1223–44.

dampen the incentive for private firms to seek short-term speculative investment opportunities, a central bank—in the U.S., the Federal Reserve System (the Fed)—could act as a countercyclical market-maker maintaining prices of certain systemically salient financial assets within a certain fundamentals-based range.[143] The Fed already conducts this kind of market-making with respect to U.S. Treasury bonds as part of its monetary policy.[144] Extending the logic of central bank trading to a broader portfolio of financial assets prone to procyclical bubble-and-bust dynamics—corporate bonds and stocks, commodities, housing prices, etc.—would fundamentally alter market participants' rational expectations with respect to private profitability of procyclical investments. To preempt speculative manias and panics in financial markets, the Fed would (1) sell assets whose price movements indicate potential speculative bubbles, thereby putting downward pressure on their prices, and (2) purchase assets whose price movements indicate potentially systemically destabilizing "fire-sale" dynamics, thereby putting a floor under the relevant market.[145]

Though the Fed's market-making actions would not aim explicitly at financial firms' internal cultural norm production, they would drastically reshape the structure of external determinants of that process. In the absence of systematic opportunities for reaping extraordinary gains from short-term speculative trading, financial firms' competitive energies would have to be redirected toward other, less systemically destabilizing, business strategies. This system-wide shift in the structure of firms' incentives and activities would, in turn, form the basis for an endogenous change in their risk culture, both at the level of individual entities and at the level of the industry as a whole.

Another potentially effective method of changing financial firms' internal risk culture would be to introduce an explicitly public element—a form of public option—directly into such firms' corporate governance structure. For instance, it is possible to envision a special "golden share" regime that would grant direct but conditional management rights to a designated government representative on the board of each financial services firm.[146] Under normal circumstances, the government appointee

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[143] *See Public Actors*, *supra* note 132, at 141–44.

[144] More specifically, the Federal Open Market Committee periodically determines broad monetary-policy targets based on the macroeconomic data at its disposal, and the FRBNY staff devises and implements its trading strategy in line with these targets. *See generally Permanent Open Market Operations*, FED. RESERVE BANK OF N.Y., http://www.newyorkfed.org/markets/pomo_landing.html.

[145] For a more detailed discussion of how the Fed would execute this strategy, see *Public Actors*, *supra* note 132, at 141–44.

[146] For a full exposition of this idea, see Saule T. Omarova, *Bank Governance and Systemic Stability: The "Golden Share" Approach*, 68 ALA. L. REV. 1029 (2017).

would function as a passive observer on the relevant firm's board of directors. However, upon the occurrence of specified triggering events—including significant lapses in the firm's legal and regulatory compliance, troubling changes in its business strategy or overall risk appetite, or signs of excessive build-up of leverage and risk in the financial system as a whole—the "golden share" would shift into an active mode, and the government representative would effectively assume the role of the firm's "manager of last resort."[147] In that role, the government would be able to take the speedy and effective action necessary to counteract socially harmful and thus irrational effects of pure market rationality.[148] Once the systemic danger subsides, the "golden share" would revert to its passive state.[149]

Again, the goal of this Article is not to defend the "golden share" proposal—or, indeed, any substantive reform proposal—on its full merits but merely to illustrate how public instrumentalities can potentially induce a fundamental endogenous change in the risk culture of individual financial services firms. By radically reducing the opportunities for systemically destabilizing risk-taking behavior, these proposed changes in key market dynamics or firms' corporate governance will fundamentally alter the structural and normative context in which the firms' organizational culture and shared value systems are formed and continuously regenerated. This distinct type of structural reform—through direct public participation in private markets and activities, rather than through exogenous regulation—potentially offers the most effective way of achieving the desired, but persistently elusive, normative change in the financial services industry.

D. Rattling the Big Matryoshka: Where in the Structure a Normative Shift Really Matters

There is little doubt that adopting an explicitly participatory market-actor approach to controlling systemic financial risk and incentivizing socially beneficial cultural change in the financial sector, described above, would represent a significant break with the existing philosophy

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[147] For a detailed discussion of the triggering events and the government's special management rights at the post-trigger stage, *see id.* at 1052–58.

[148] The "golden share" regime would not merely replicate the existing system of regulatory oversight of financial services firms. By contrast, it will expand the range of potential levers of systemic stabilization available to financial regulators. As an internal corporate actor, the government will be able to use the mechanisms of internal corporate governance to make necessary adjustments to individual firms' behavior in a far more flexible and timely fashion. *See id.* at 1061–62.

[149] *Id.* at 1055–57.

of financial sector regulation.[150] It is a known fact that government instrumentalities routinely transact in a wide array of ostensibly private financial markets.[151] Yet, a full recognition and programmatic use of this practice as a critical tool of public policy requires a fundamental rewiring of the current discourse on the substance and methods of effective macroprudential regulation of finance. At present, the scope of macroprudential oversight is limited primarily to matters of capital adequacy, liquidity management, resolution regimes, and other similarly technical aspects of financial firms' business operations.[152] Expanding that domain to incorporate public instrumentalities' direct market activities, undertaken with an explicit view toward manipulating macro-level dynamics, is a logical step forward—as well as a controversial one.

More generally, operationalizing a program of proactive and deliberate use by the government of its market-actor powers would require a critical reassessment of the social purposes and functions of the financial system and its constitutive components. Just like an individual's normative choices reflect that individual's interactions with the surrounding organizational culture (that of the firm), the financial system's normative dynamics are fundamentally tied to, and reflect its interactions with, the surrounding layer of the "real" economy. In this context, the financial system's principal purposes and functions cannot be understood in purely self-referential, transactional terms: they can only be determined by reference to the broader economy and society.[153] The "higher" purpose of financial institutions, embedded in the social system, is not simply to serve their clients' private interests but also to serve societal interests.[154]

Accordingly, the normative scale on which to judge the functioning—or malfunctioning—of financial markets and institutions must be expanded beyond the narrowly self-referential notions of "market efficiency" to encompass a broader view of social efficiency. A well-functioning—or "good"—financial system is one that continuously allocates capital to productive non-financial enterprise and enables sustainable, structurally balanced, and socially inclusive long-term growth of the real

150 *See* Saule T. Omarova, *The Dodd-Frank Act: A New Deal for A New Age?*, 15 N.C. BANKING INST. 83 (2011) [hereinafter, *"A New Deal for A New Age?"*] (analyzing the key elements of the regulatory philosophy in the financial sector).

151 *See generally* sources cited *supra* note 132.

152 *See generally* sources cited *supra* note 3.

153 *See generally* Robert C. Hockett & Saule T. Omarova, *The Finance Franchise*, 102 CORNELL L. REV. 1143 (2017) [hereinafter, "*Finance Franchise"*] (offering a comprehensive narrative of the modern financial system's function and relation to the broader economy and polity).

154 *See id.* at 1212–15. For a discussion of the narrowly self-referential approach, see *supra* note 69 and accompanying text.

economy.[155] Conversely, a malfunctioning—or "bad"—financial system is one that continuously misallocates credit and money to unproductive financial speculation, thereby undermining the real economy's capacity for long-term growth. Explicitly articulating and endorsing these normative principles would significantly broaden the scope of public policy choices and tools. It would provide a solid normative basis for adopting more assertive macro-level, structural approaches to correcting the currently dysfunctional dynamics in the financial system, including the approaches discussed above.[156]

An explicit incorporation of this systemic view of the purposes and functions of finance, in turn, requires a fundamental rethinking of the proper balance between public and private interests, capabilities, and roles in the economy and, ultimately, polity. The currently dominant understanding, ideologically rooted in the tenets of neoliberalism, posits a deep divide in the relative competencies of the state (public) and the market (private).[157] To put it simply, the neoliberal paradigm views the economy as a quintessentially private realm and, accordingly, presumes the normative primacy of private over public in the economic sphere.[158] Not only is this view descriptively misleading, but it is also normatively indefensible: it serves as the ultimate basis for justifying and legitimizing pursuit of private gain by private actors at any (or nearly any) social cost. As discussed above, it is precisely this kind of skewed normative judgment that is at the heart of the present systemic dysfunction in modern finance.[159]

A radical redrawing of this conceptual boundary between public and private is necessary in order to assert the normative primacy of the public not only at the level of the polity but, importantly, at the level of the economy—and every other level of the Matryoshka-like socio-cultural system.[160] It means, in particular, that the public's interests, capabilities, and roles should be fully acknowledged and deliberately prioritized in

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[155] For a full elaboration of this argument, see *Public Actors*, *supra* note 132; Robert C. Hockett & Saule T. Omarova, *Private Wealth and Public Goods: A Case for a National Investment Authority*, 43 J. CORP. L. (forthcoming 2018).

[156] *See supra* Part IV.B–C.

[157] *See, e.g.*, David Singh Grewal & Jedediah Purdy, *Introduction: Law and Neoliberalism,* 77 L. & CONTEMP. PROBS. 1 (2015) (arguing that neoliberalism systematically puts capitalist market imperatives over democratic imperatives); Michael Walzer, *Liberalism and the Art of Separation*, 12(3) POLITICAL THEORY 315 (Aug. 1984) (arguing that separation of the public and private spheres is at the core of liberalism).

[158] *See Public Actors*, *supra* note 132, at 113–14.

[159] *See A New Deal for A New Age?*, *supra* note 150, at 94–97 (arguing for the need to overcome the deeply engrained normative bias in favor of protecting private actors' right to pursue economic gain over the public's right to be protected from resulting economic harms).

[160] *See supra* Part II.D. Of course, this is not meant as a blanket denial of individuals' right to privacy, self-determination, or personal autonomy. The subject of this Article is specifically limited to the structure and dynamics of the system of norms and cultural attitudes

the operation, regulation, and culture of the financial system—and individual financial services firms it comprises.[161]

In that sense, a fundamental normative and cultural change is, in fact, the first-order priority on the financial sector reform agenda. That change, however, has to start not at the level of individual bankers or firms, the smallest pieces hidden inside the nesting doll, but at the highest level of a self-reflecting and self-constituting polity—the biggest Matryoshka that contains and carries the whole lot. That is where the most important and urgently needed normative shift has to occur, if we are serious about improving the ethics and culture of risk-taking in the financial sector.

CONCLUSION

This Article examined the principal themes in the newly reinvigorated public debate on the role of ethical norms and cultural factors in reducing socially excessive levels of risk in modern financial markets. The Article argued that the main conceptual and normative limitations of the current discussions and proposed reform measures derive from their exclusive focus on the organizational culture of an individual financial services firm. To overcome these limitations, it is critical to shift the focus away from the predominantly individual entity-level analysis toward the broader systemic aspects of modern finance.

The Article further argued that improving the presently dysfunctional risk culture of financial services firms requires a deep rethinking of, and changes in, the basic structure and dynamics of the entire financial system—and, ultimately, the broader normative framework within which it operates. How "ethical" or "unethical" the financial industry's conduct or shared norms are is an issue inextricably linked to the broader question of how effective or ineffective the financial system is in discharging its basic social function. As one observer put it,

> Finance has become the tail that wags the dog. Until we start talking about how to create a financial system that really serves society, rather than just trying to stay ahead of the misdeeds of one that doesn't, we'll struggle

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underwriting the currently pervasive pattern of socially excessive risk-taking in the financial sector. That is the "system" to which I refer here.

[161] *See Finance Franchise*, *supra* note 153 (redefining the basic narrative of modern finance as a public-private franchise arrangement, in which the public acts as the franchisor effectively licensing private financial institutions to dispense a vital public resource, the sovereign public's full faith and credit).

> in vain to bridge the gap between Wall Street and Main Street.[162]

The real problem with Wall Street's culture, therefore, is much more fundamental than simply "wrong" compensation practices or "tone from the top" at individual banks. Until we find the right structural means of preventing excessive generation and accumulation of systemic financial risk on a macro-level, we will search in vain for plausible means of fostering a socially responsible risk culture in the financial sector. In the final analysis, the key to making modern finance ethically sound is to make it structurally sound, and vice versa.

162 Rana Foroohar, *How Big Banks Became Our Masters*, N.Y. TIMES (Sept. 27, 2017), https://www.nytimes.com/2017/09/27/opinion/how-big-banks-became-our-masters.html.