Risk management in a customer-owned bank
A case study of Länsförsäkringar Bank

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Title: Risk management in a customer-owned bank - A case study of Länsförsäkringar Bank.

Background: In the wake of the latest financial crisis, which was characterized by excessive risk-taking and short-term behavior to increase shareholder values, there has been a shift from financial risk management to enterprise risk management (ERM). New regulations have been introduced to sharpen the risk management in the financial service sector, but these regulations have been criticized for being too standardized and encouraging uniformity. From a risk perspective customer-owned banks are interesting as they generally are more risk averse and long-term oriented than shareholder-owned banks. Still, customer-owned banks also have to comply with the stricter regulations, which are perceived to be designed primarily for shareholder-owned banks.

Purpose: The purpose of this research is to understand how a customer-owned bank manages risks at multiple organizational levels, and how the bank is affected by regulatory pressures.

Method: In order to fulfill the stated purpose and answer the research question, a single case study of the Swedish bank Länsförsäkringar Bank (LF Bank) is conducted. The case study is primarily based on interviews performed with representatives from LF Bank, and further supplemented with internal documents provided by the respondents and publicly available documents from the bank’s website.

Conclusion: Based on the principles of customer-ownership, LF Bank has chosen to have a low risk profile. The bank is practicing risk management in accordance with the ERM approach, whereby risk management is aligned with strategic objectives and integrated into the management control system. The stricter regulations have led to increased centralized control and administration. However, the employee empowerment and motivation have not been reduced. The results show that the customer-ownership of LF Bank has facilitated the implementation of the regulations as the organizational culture is based on customer protection. We can conclude that LF Bank’s low risk appetite is embedded in their customer ownership, and not a consequence of stricter regulations.

Suggestion for further research: We suggest that a comparative case study is conducted in future research in order to increase the understanding of the differences between how a customer-owned bank and a shareholder-owned bank manage risks and are affected by regulatory pressures.

Key words: Risk management, enterprise risk management, customer-owned banks, management control, banking regulations.
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This chapter presents the background of the thesis and discusses the research problem. It further introduces the research question and research purpose, and illustrates the disposition of the thesis.

1. BACKGROUND AND PROBLEM DISCUSSION

During the financial crisis of 2008, risk management turned out to be weak (Paape & Speklé, 2012). Principles, frameworks and processes used to manage risk did not prevent excessive risk-taking (Kirkpatrick, 2009; Soin & Collier, 2013). Michie (2011) argues that excessive risks were taken by firms to increase financial returns to shareholders. This is also highlighted by Kaplan (2009) who claims that shareholder value and revenue growth characterized firms’ management systems at the time of the financial crisis, with focus to obtain short-term financial gains. Risk management therefore received a lot of criticism during the period of financial turbulence, which has pressured firms to reinforce their risk management systems (Paape & Speklé, 2012; Wahlström, 2013). In addition, the view of risk management as a compliance function, separated from the business processes, has been criticized (Arena, Arnaboldi & Azzone, 2010; Kaplan, 2009; Kaplan & Mikes, 2012; Van der Stede, 2011).

As a result, the concept of risk management has become broader in recent years. In order to improve the management of risk (Paape & Speklé, 2012), there has been a shift from financial risk management to enterprise risk management (ERM) (Arena et al., 2010; Giovanni, Quarchioni & Riccaboni, 2014; Scheytt, Soin, Sahlin-Andersson & Power, 2006; Soin & Collier, 2013). This implies that a more extensive package of risks is managed than solely financial risks (Arena et al., 2010), including market risk, credit risk, operational risk and compliance risk (Merchant & Otley, 2007). ERM is a holistic and integrated approach that correlates risk management with business strategy and objective-setting, whereby it becomes a part of senior managements’ daily work (Arena et al., 2010; Kaplan, 2009; Paape & Speklé, 2012; Power, 2009). Mikes (2009) therefore describes ERM as a framework applied to manage risks essential to reach strategic objectives. Consequently, risk management has become increasingly integrated into the management control system (Bhimani, 2009; Merchant & Otley, 2007; Miller, Kurunmäki & O’Leary, 2008). This trend has motivated a number of calls, within the management control area, for studies of risk management from a management control view (Arena et al., 2010; Mikes, 2009; Paape & Speklé, 2012). We aim to contribute to the management control literature by studying how risk management is practiced at multiple organizational levels; the implications for banks that fall outside the regulatory norm and; the implications of the regulations for the employees.

Mikes (2009) argues that there is a lack of practical knowledge concerning ERM. Arena et al. (2010) claim that the organizational dynamics of ERM should be further studied. In addition, Paape & Speklé (2012) highlight the lack of knowledge of how risk management is integrated into firms’ management control systems to “guide the behaviour of lower level managers” (p. 561). Finally, Wahlström (2013) emphasizes that additional research should study banks’ intra-organizational communication with regards to risk management. We aim to contribute to
this research by studying how risk management is practiced at multiple organizational levels, from a management control perspective.

The financial sector, and particularly the banking industry, was severely affected by the financial crisis of 2008 (Van der Stede, 2011; Wilson, Casu, Girardone & Molyneux, 2010). According to Birchall (2013), high risk-taking behavior was the fall for many banks during this period. The regulatory response has been to impose stricter regulations related to risk management (Wilson et al., 2010). The ERM approach has been encouraged by banking regulators as it provides useful techniques for bank capital adequacy calculation (Mikes, 2009). One potential problem of the banking regulations is the high level of standardization which may encourage uniformity among banks (Cäker & Elliot, 2014; Michie, 2011; Power, 2009; Van der Stede, 2011; Wahlström, 2009). Cäker and Elliot (2014) find that large banks can better respond to the regulatory pressures than small banks as they have greater resources. Wahlström (2009) argues that the stricter regulations are more suitable for centralized banks than decentralized banks. Michie (2011) describes that shareholder-owned firms are promoted by regulators in the financial services sector, whereby non-shareholder-owned firms are pressured to act as shareholder-owned firms. In order to respond to the regulatory requirements and thereby gain legitimacy, banks that diverge from the regulatory intention may be pressured to change by adopting risk practices that differ from those currently in use within the bank.

Customer-owned banks are in contrast to shareholder-owned banks not controlled by a group of investors (Birchall, 2013). Ayadi, Llewellyn, Schmidt, Arbak and De Groen (2010) argue that customer-owned banks therefore tend to be more risk averse than shareholder-owned banks. The authors provide three main reasons: customer-owned banks are not pressured to maximize profit in order to provide dividends to shareholders; it is more difficult for customer-owned banks to increase the external capital; customer-owned banks are more long-term oriented as they are under less short-termist pressure. Hence, from a risk perspective, customer-owned banks are interesting as they tend to have a lower risk profile than shareholder-owned banks. This further motivates that risk management systems that ensure low risk behavior throughout the organization are implemented in a customer-owned bank. As mentioned above, the financial crisis was characterized by excessive-risk taking to create shareholder value, whereby stricter regulations have been introduced. For customer-owned banks it is a necessity to act in line with the regulations in order to gain and maintain legitimacy. Not only is it much more difficult to raise external capital in a customer-owned bank, but non-compliance may also result in bad publicity and the loss of customers. Mikes (2009) emphasizes the importance of bearing in mind that the choice and use of ERM practices may be influenced by institutional pressures. Therefore, we further aim to study how regulations primarily designed for shareholder-owned banks affect the risk management in a customer-owned bank.

In customer-owned organizations, the care for the customers is a prerequisite for continued business. The employees are therefore emphasized as important as they are working with the customers. This view is a great asset in customer-owned organization since it encourages production of high quality services (Jussila, Kotonen & Tuominen, 2010). In addition to the
problem of standardization, noted above, a second potential problem of the regulations, which have been discussed in the literature, is the effect that it may have on the employees (Power, 2009; Wahlström, 2009; Wahlström, 2013). According to Power (2009), regulatory requirements put a lot of pressure on employees at operational levels, which can reduce their intrinsic motivation. Wahlström (2009) argues that the banking regulations lead to more centralized control, which is problematic in organizations with a culture based on employee empowerment. Wahlström (2013) further claims that regulation can lead to reduced employee commitment as it encourages reliance of risk measures rather than employees' professional judgment. We believe that increased control and workload indirectly can have a negative impact on the customer satisfaction, which is of high importance in a customer-owned organization. Wahlström (2009) highlights that future research should study how working conditions and employee motivation are affected by regulations. We therefore aim to study how employees in a customer-owned bank are affected by regulatory pressures.

To sum up, in this thesis we respond to the research calls highlighted in previous research by studying how a customer-owned bank is managing risks at multiple organizational levels, and how the bank is affected by regulatory pressures.

1.2 RESEARCH QUESTION

Based on the background and problem discussion, we aim to answer the following research question:

How does a customer-owned bank manages risks at multiple organizational levels, and how is the bank affected by regulatory pressures?

1.3 RESEARCH PURPOSE

The purpose of this research is to understand how a customer-owned bank manages risks at multiple organizational levels, and how the bank is affected by regulatory pressures. In order to fulfill this purpose, a case study of a customer-owned bank is conducted.
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This chapter presents the literature review and theoretical framework of the research. This includes a discussion of the view and use of risk management, and risk management from a contingency-, institutional-, and management control perspective.

2.1 THE VIEW OF RISK MANAGEMENT

Risk management has been viewed as a task for risk experts (Arena et al., 2010; Kaplan, 2009; Kaplan & Mikes, 2012; Mikes, 2011; Van der Stede, 2011). Van der Stede (2011) argues that risk management can either be regarded as solely a “compliance exercise” (p. 615), or as an important element in the performed business activities. Kaplan (2009) claims that senior executives often consider risk management as a compliance function. According to Kaplan and Mikes (2012), this can even explain why some banks failed in the financial crisis as the communication between risk managers and top management is limited. Van der Stede (2011) further discuss risk management from a responsibility perspective, and explains that risks can be either “externalized” or “personalized”, whereby the former category view risks as “someone else’s responsibility” and the latter category view of risks as “everyone’s responsibility” (p. 615). Mikes (2011) argues that the organizational significance of risk management depends on the risk managers and their ability to make those practices appear as necessary and unavoidable, defined as “black-boxing” (p. 229).

2.2 IDEAL RM TYPES

In her study of risk management in banks, Mikes (2009) identified four different RM types which she named “four ideal RM types”. In this section we present these risk management approaches as they offer a means to understand how a customer-owned bank manages risks.

The first ideal type is labeled risk silo management, and is related to risk quantification. Risks are often categorized into different risk types such as market risk, credit risk, insurance risk and operational risk, which are increasingly being quantified, measured and controlled. Recommended techniques within the management approach are loss distributions, value-at-risk, credit rating models, and standardized and advanced measurement approaches set by regulators. Mikes (2009) emphasizes that the international bank regulations have been greatly influenced by the progress made within risk silo management.

The second ideal type is called integrated risk management, and is connected to risk aggregation. The economic capital framework is central within the management approach, which involves aggregation of quantifiable risks into a total risk estimate with the use of a common denominator for market, credit and operational risks, whereby risks can be measured, compared and controlled within the firm. As practitioners have considered the economic capital as best practice, the technique has been legitimized by regulatory bodies in the banking sector. In addition, the rating agency community has played an important part in spreading the use of economic capital, especially since banks’ holdings of excess capital.
influence their credit ratings (Mikes, 2009). According to Power (2009) firms can choose to hold more excess capital than required by regulators in order to obtain a good credit rating.

The third ideal type is risk-based management, which is a management approach related to risk-based performance measurement. The main focus of the management approach is to connect risk management with performance measurement and calculating shareholder value creation. Recommended techniques within risk-based management are risk-adjusted return on capital (RAROC), shareholder value added, risk pricing, risk transfer and portfolio risk management (Mikes, 2009).

The final ideal type is defined as holistic risk management, and is connected to the management of non-quantifiable risks. The importance of observing and controlling non-quantifiable risks such as environmental risks and reputational risks has been highlighted. Thus, it has been considered important to complement the risk management framework with non-quantifiable risks. The management approach further focus on giving senior management a strategic view of risks. Recommended techniques within holistic risk management are scenario analysis, sensitivity analyses, risk mapping and special risk reviews (Mikes, 2009).

2.3 RISK MANAGEMENT AND OWNERSHIP STRUCTURE: A CONTINGENCY PERSPECTIVE

In this section we adopt insights from the contingency literature that will help us to understand how the ownership structure affects banks’ risk management. This, in turn, can help us to understand how a customer-owned bank manages risks. Within management accounting research, references to contingency theory are frequently made in order to explain management accounting practices (Ryan, Scapens & Theobald, 2002). The contingency approach is built on the idea that the organizational context influences the design and use of firms’ accounting systems (Otley, 1980; Chenhall, 2003).

Ownership structure is one key variable that influences firms’ accounting systems (Ferreira & Otley, 2009). With regards to customer-owned banks, they are generally more risk averse than shareholder-owned banks, especially because less pressure is exerted on them to maximize profit in order to offer dividend to shareholders (Ayadi et al., 2010; Birchall, 2013). Moreover, customer-owned banks have a lower risk profile as it is more difficult to increase the external capital, and since their business decisions and lending policies are based on a long-term perspective (Ayadi et al., 2010). Having this in mind, the principles of customer-ownership can be expected to influence the risk management systems adopted by a customer-owned bank (Ayadi et al., 2010; Ferreira & Otley, 2009).

2.4 RISK MANAGEMENT: AN INSTITUTIONAL PERSPECTIVE

In this section we present central notions within the institutional theory which can help us to understand how customer-owned banks’ risk management practices are affected by regulatory pressures. Institutional theory strives to increase the understanding of organizational homogeneity (Greenwood & Hinings, 1996). More specifically, the theory aims to explain how organizational change is increasingly driven by pressures from the society. The theory is built on the assumption that organizations and the environment influence each other, whereby
organizations have to be structured and behave in line with the pressures from the society (Meyer & Rowan, 1977; DiMaggio & Powell, 1983).

Within the institutional theory, there are two main driving forces that can explain why organizations change and become more homogenous; the search for improved efficiency and the search for legitimacy. The former involves organizations adopting similar operational procedures in order to enhance the effectiveness. In contrast, organizations can adopt practices that are “normatively sanctioned” (DiMaggio & Powell, 1983, p. 148), in order to gain legitimacy (DiMaggio & Powell, 1983; Meyer & Rowan, 1977). Legitimacy concerns the importance of organizations to be perceived as socially acceptable and thereby gain public trust (Meyer and Rowan, 1977). Meyer and Rowan (1977) emphasize that organizations increasingly are becoming more similar as a result of the search for legitimacy, without automatically becoming more efficient, which DiMaggio and Powell (1983) define “status competition” (p. 154). A central concept within the institutional theory is decoupling, which involves institutionalized organizations informally restructuring their activities to act in line with standardized and legitimizing formal structures to gain legitimacy, but still protect their own formal structures. Thus, organizations may appear as acting in line with external institutionalized practices, but their actual practices may in fact diverge from such practices (Meyer & Rowan, 1977).

DiMaggio and Powell (1983) present the concept of isomorphism, and identify three isomorphic processes: coercive, mimetic and normative, that can explain the increasing similarity among organizational fields. Coercive isomorphism stems from external pressures of both formal and informal character, from other organizations and the society. Mimetic isomorphism involves imitation of successful and legitimate organizations within the same organizational field, partly to comply with uncertainty. Normative isomorphism stems primarily from professionalization, where universities and professional training institutions influence and shape individuals in the organizational field to become more homogeneous. This as organizations within the same field tend to recruit individuals from the same schools and with the same backgrounds. We primarily draw on the coercive isomorphism as we study how regulatory pressures affect a customer-owned bank. The mimetic isomorphism is further of relevance in order to study how a customer-owned bank handles how external expectations.

With regards to risk management, regulators put isomorphic pressure on firms to adopt and conform to modern standardized risk management practices (Kaplan, 2009; Miller, Kurunnäki & O’Leary, 2008; Paape & Speklé, 2012; Power, 2009; Scheytt et al., 2006). Kaplan (2009) highlights that risk management has been institutionalized in the banking sector as a result of the international banking regulations. ERM has been supported by regulatory bodies as it can provide useful techniques for bank capital adequacy calculation, whereby the approach has been adopted by lots of banks (Mikes, 2009). As mentioned in the first part of this research, one potential problem of the banking regulations is the high level of standardization which may encourage uniformity among banks (Cäker & Elliot, 2014; Goodhard & Wagner, 2012; Power, 2009; Van der Stede, 2011; Wagner, 2009; Wahlström, 2009). Van der Stede (2011) states that: “regulation implies that there is a ‘best way’ to achieve a desired outcome” (p. 609). Michie (2011) points out that the large shareholder ownership model dominates the
financial services sector, where regulators even pressure non-shareholder-owned firms to act as shareholder-owned firms. Hence, this may imply that regulators pressure customer-owned banks (Michie, 2011) to change their existing risk management by adopting legitimate risk management practices (DiMaggio & Powell, 1983; Meyer & Rowan, 1977; Miller, Kurunmäki & O’Leary, 2008; Paape & Speklé, 2012; Power, 2009; Scheytt et al., 2006). This even though customer-owned banks in general have a lower risk appetite than shareholder-owned firms (Ayadi et al., 2010; Birchall, 2013), and the fact that larger risks were taken to increase financial returns to shareholders during the financial crisis of 2008 (Michie, 2011; Kaplan, 2009).

The “legitimacy-driven style of risk management” (Power, 2009, p. 854) has been criticized in the risk management literature (Giovanni, Quarchioni & Riccaboni, 2014; Huber & Scheytt, 2013; Miller, Kurunmäki & O’Leary, 2008; Paape & Speklé, 2012; Power, 2009). Miller, Kurunmäki and O’Leary (2008) argue that complying with compulsory risk management models does not per se equal to good management of risks. Power (2009) discusses this from a more extreme point of view and argues that a potential result can be the “risk management of nothing”, where ERM turn into a rule-based compliance practice which not influences managers’ daily work. Hence, it may not in fact lead to enhanced management of risks, it may rather involve showing off as risk conscious to gain legitimacy. It has therefore been argued that more diversity should be promoted by regulators rather than best practice (Goodhard & Wagner, 2012; Michie, 2011; Power, 2009).

2.5 THE USE OF RISK MANAGEMENT: A MANAGEMENT CONTROL PERSPECTIVE

2.5.1 CONTROL TACTICS

In this section we present Merchant’s (1982) and Merchant and Van der Stede’s (2007) four categories of control tactics: action control, results control, personnel control and cultural control. These can be used and combined by organizations to make sure that employees’ behaviors are in line with the organizational goals and strategies. The typology is useful to help us better understand how a customer-owned bank manages risks at multiple organizational levels.

Action control focuses explicitly on controlling employees’ actions or decisions in order to encourage desirable actions. This control tactic usually involve implementation of behavioral constraints, work rules, policies and procedures, and direct supervision. Results control implies that employees are being accountable for their results, and is used in order to encourage them to take decisions that will generate the desired outcome. Performance measurement, performance goals and rewards/punishments are central elements in this control tactic. Personnel control involves encouragement of employees to engage in self-monitoring. Such controls are implemented to increase the probability that employees will carry out the desired work adequately on their own, by upgrading their capabilities, enhancing the internal communication and promoting peer control. This includes training programs, clear role descriptions and establishment of shared goals (Merchant, 1982; Merchant & Van der Stede, 2007). Finally, cultural control concerns the creation of behavioral norms within an
organization in order to promote employees to supervise and influence each other's behaviors. The culture within an organization tends to stay fixed over time and therefore it may be possible to identify an organizational culture by asking employees with long tenure within the organization questions like “what are you proud of around here?” (Merchant & Van der Stede, 2007, p.85). If there is a strong culture within the organization the answers can be expected to be consistent among the employees. In order to create an organizational culture, managers use methods such as group rewards and code of conduct. The latter method is used by forming documents with widespread statements concerning organizational values which communicate the expected behavior of the employees (Merchant & Van der Stede, 2007). Implementation of action- and results controls implies that employees' behaviors are controlled directly. In contrast, personnel- and culture controls intend to indirectly control employees' behavior by influencing their values, norms and ideas (Alvesson & Kärreman, 2004).

With regards to risk management, Kaplan and Mikes (2012) emphasize the importance of using different control processes for different risks in order for risk management to be active and cost-effective. The authors state that: "risk management is too often treated as a compliance issue that can be solved by drawing up lots of rules and making sure that all employees follow them” (p. 50). Wahlström (2013) highlights the danger of relying on risk measures instead of employees' professional judgment as it may lead to reduced employee commitment. Arena et al. (2010) point to the importance of creating a risk management culture across organizations as this determines the effectiveness of risk management.

2.5.2 ORGANIZATIONAL STRUCTURE

In this section, we discuss the organizational structure as a control element and how banks’ organizational structure are affected by regulatory pressures. This helps us to understand how banks’ risk management activities and roles, at multiple organizational levels, are affected by regulatory pressures. The organizational structure is a fundamental control element that influences employees’ behavior (Adler, 2011; Ferreira & Otley, 2009). The organizational structure comprises different variables including centralization, autonomy and formalization (Chenhall, 2003; Otley, 1980; Ouchi, 1977), which affect the efficiency, motivation and information flows within an organization (Chenhall, 2003).

We draw on Cummings (1995) who argues that the hierarchical level where the important decision-making is made, determines whether an organization is centralized or decentralized. This means that an organization is centralized when key business decisions are made at central level and decentralized when important decision-making is made at lower organizational levels. Wahlström (2009) claims that employee empowerment is important in decentralized organizations, and can result in increased motivation and commitment among the employees. The design of the organizational structure can be affected by the controls used within a firm (Merchant, 1982). Wahlström (2009) claims that Swedish banks have to adjust their management structures to adapt to the new regulations. According to the author, among other things, more centralized control and administration is needed in order to implement and realize the benefits of the regulations. He argues that the regulations require implementation of new systems, which in turn involve reporting of data to headquarters. Wahlström (2009)
further explains that this can become problematic in decentralized organizations as it differs from organizational traditions.

The increased focus of risk management and ERM has resulted in changing work tasks and new professions (Arena et al., 2010; Kaplan & Mikes, 2012; Kirkpatrick, 2009; Paape & Spekle, 2012; Wahlström, 2013). The board of directors is now responsible for controlling and guiding risk policy and implementing appropriate risk management systems and control mechanisms that supervise the risk appetite of the firm (Kirkpatrick, 2009). Furthermore, risk management specialists, internal auditors and management accountants have been given more significant roles (Arena et al., 2010). The internal audit function is responsible for controlling that the behavior of the employees are in line with internal controls and standard operating processes (Kaplan & Mikes, 2012). Risk management practices are furthermore supervised by audit committees (Paape & Speklé, 2012). In addition, to manage strategy- and external risks, firms usually require a separate risk function that report directly to the top management (Kaplan & Mikes, 2012). A new organizational role has further been developed, the Chief Risk Officer (CRO) (Arena et al., 2010) which has the main responsibility for risk management (Paape & Speklé, 2012) and supports managers to take responsibility for risks (Arena et al., 2010).

Wahlström (2009) finds that there can exist knowledge gaps between the staff within banks because of their different responsibilities and frame of references. In particular, his study illustrates the potential contradicting opinions that may arise between staff responsible for risk measurement and assessment, and staff responsible for the operations. In his study, the latter group was more skeptical towards risk quantification, whereas the former group was more positive to the stricter banking regulations. This is in line with Power (2009), who claims that employees responsible for risk and compliance favor the “rule-based world” (p. 852). In addition, Power (2009) argues that regulatory requirements put a lot of pressure on employees at operational levels, and might therefore reduce their intrinsic motivation. According to Wahlström (2013), stricter banking regulations have led to several administrative routines, which could explain why banking staff responsible for the operations are more negative to the regulations.
3. METHOD

This chapter presents the research design, and the choice of research method. It further discusses ethical issues and the actions made to enhance the quality of the research.

3.1 RESEARCH APPROACH

Since the aim of this study is to understand how a customer-owned bank manages risks at multiple organizational levels, and how the bank is affected by regulatory pressures, we draw on the interpretivist paradigm. By adopting such an approach we hope to understand “the social nature of accounting practices” as described by Ryan et al. (2002, p. 145). The interpretivist paradigm is based on the premise that people are formed by their perceptions which makes the social reality subjective (Collis & Hussey, 2014). Interpretive research therefore finds social systems to be influenced by the activities of individuals and to be socially constructed (Ryan et al., 2002). As in-depth knowledge is required to understand how a customer-owned bank manages risks at multiple organizational levels, and how the bank is affected by regulatory pressures, a qualitative research approach is taken in accordance with Trost (2010) and Yin (2009). This is according to Collis and Hussey (2014) further consistent with the interpretive research.

We rely on insights from both institutional theory and contingency theory. The institutional theory is the main theoretical framework. The theory is used to understand how institutional pressures affect how a customer-owned bank manages risks, and how external expectations are handled by the bank. More specifically, we use notions within institutional theory to analyze the empirical findings and to either retain, modify or reject the theory. Institutional theory is complemented with contingency theory in order to explain the meaning of the ownership structure for the use of risk management.

The second part of our stated purpose concerns how a customer-owned bank is affected by regulatory pressures. By regulatory pressures we mean directives imposed by Finansinspektionen (FI), which is Sweden’s financial supervisory authority responsible for developing regulations and ensuring regulatory compliance. FI introduces both mandatory directives and directives where one can choose to comply or explain why choosing another track (Finansinspektionen, 2015).

3.2 SEARCH OF SOURCES

As recommended by Collis & Hussey (2014) and Ryan et al. (2002), we started our study by reviewing the existing body of knowledge within the field in order to identify potential research opportunities and come up with a relevant research question. Academic articles have been read to identify the main and latest advances as well as the present debates and issues related to the research area and research phenomenon. In order to find credible sources, the search for sources was performed using the databases available at Gothenburg University Library and the academic search engine Google Scholar. The aim was to use academic articles that were published relatively recent and cited a large number of times. The primary areas of
interest have been risk management, enterprise risk management, management control, banking regulations, customer-owned banks, institutional- and contingency theory. In the beginning, the search for sources was relatively broad, but it became successively more specific during the research process. The literature has systematically constructed the frame of reference, and proceeded throughout the research in order to update the frame of reference in conjunction with the collection of the empirical material.

3.3 RESEARCH DESIGN

As a holistic understanding is required to answer the research question and fulfill the stated purpose, a case study of the Swedish bank Länsförsäkringar Bank AB (LF Bank) is conducted. A single case study is conducted since we aim to receive rich empirical information about how a customer-owned bank manages risks and how a customer-owned bank is affected by regulatory pressures. As described by Kvale and Brinkmann (2009), case study research offer the means to obtain a rich picture and understanding of a research phenomenon in a particular setting. This by collecting data from multiple sources that enables capturing of separate impressions of one subject. Another advantage of case study research, as highlighted by Collis and Hussey (2014), is that data triangulation reduces bias in the data sources.

In order to understand the current risk management practices in LF Bank and how the bank is affected by regulatory pressures, an exploratory case study is conducted in accordance with Ryan et al. (2002). The case study is primarily based on interviews with representatives at LF Bank, but further supplemented with internal documents provided by the respondents and publicly documents available at Länsförsäkringar’s website. As noted by Collis and Hussey (2014), case study research is time-consuming and challenging as it can be difficult to define the scope of the study. After the interviews were conducted, the potential value of comparing a customer-owned bank with a shareholder-driven bank was realized. This as the respondents from LF Bank to a large extent compared the bank with shareholder-driven banks. Hence, it could have been beneficial to perform a multiple case study, studying both a customer-owned bank and a shareholder-owned bank to collect comparable data.

3.3.1 SELECTION OF CASE COMPANY

In order to answer the research question “How does a customer-owned bank manage risks at multiple organizational levels, and how is the bank affected by regulatory pressures?” the most important criteria was to select a customer-owned bank. The choice of LF Bank as research object was primarily due to the fact that they in advance of this research showed interest in starting a cooperation with the University of Gothenburg. Thus, there were favorable prospects to conduct interviews with several representatives. In addition, LF Bank is, except from two minor banks, the only customer-owned bank in Sweden.

LF Bank is a customer-owned bank that was established in 1996 when the Länsförsäkringar Alliance expanded and diversified their business from solely working with insurances (Länsförsäkringar, 2014). The bank’s organizational form differs from that of most other
banks in several ways. First, the bank is owned by their customers, which separates them from the traditional shareholder-owned bank. As mentioned in the previous chapter, customer-owned banks are considered to have less incentives to take excessive risks than shareholder-owned banks. This as customer-owned banks not are pressured to maximize profit in order to provide dividends to shareholders, and therefore can be more long-term oriented. In addition, it is more difficult for customer-owned banks to increase the external capital. LF Bank describes that their operations are based on low risk and a long-term mind-set (Länsförsäkringar, 2014). This strategy was settled in the year of 2000, thus before the latest financial crisis.\(^1\) Second, LF Bank is organized under independent, regional business units with a supporting central function. The bank argues that this structure enables local customer- and market knowledge, and contributes to customer satisfaction. Business decisions are further taken at a local level (Länsförsäkringar, 2014). Based on these traits LF Bank appears to be a decentralized organization from the outside.

We find LF Bank suitable for studying the consequences of regulatory pressures for primarily two reasons. First, as described above, LF Bank has before the recent financial crisis and the introduction of stricter regulations strived to maintain a low risk appetite within the bank. However, the stricter regulations might pressure LF Bank to change by adopting risk practices that differ from those currently in use within the bank. As LF Bank is a customer-owned bank it is a necessity to act in line with the regulations in order to gain and maintain legitimacy. Not only as is it more difficult to raise their external capital, but non-compliance may also result in bad publicity and the loss of customers. Second, as regulations tend to increase centralization, we believe stricter regulations might obstruct the employee empowerment on local level and in turn negatively affect the customer satisfaction.

3.4 DATA COLLECTION

3.4.1 PRIMARY DATA

Primary data was collected through qualitative interviews. As noted by Brinkmann and Kvale (2015) and Silverman (2011) interviews offer the means to capture the subjective experience from the people interpreting and acting by the set activities and thereby reveal the circumstances by which the research phenomenon arise. This has in accordance with Brinkmann and Kvale (2015) and Trost (2010) enabled collection of rich information and identification of interesting patterns. The interviews were both individual- and group interviews, and were conducted face-to-face and via telephone. The interviews were semi-structured based on an interview guide with prepared questions (see Appendix 1) in order to follow a theme (Kvale & Brinkmann, 2009). This interview style was, in line with Ryan et al. (2002), chosen to obtain comparable information.

An interview includes both personal interaction and knowledge exchange between the interviewer and the interviewee. As noted by Kvale and Brinkmann (2009) the phenomenon

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\(^1\) LF Bank argues that their long-term focus is one of the key reasons for their successful performance during the recent financial crisis (Länsförsäkringar Bank, 2008).
under study is therefore constructed and formed through the respondents answers and how the interviewer interpret the information. Hence, as emphasized by Collis and Hussey (2014) it is important to bear in mind that collecting data by interviews could imply some biases as the space of interpretations is large. During the interview process, we therefore attempted to avoid preconceptions. In particular, as the respondents at central levels were interviewed before the respondents on local level, we have tried to avoid preconceptions when interviewing local practitioners. To further reduce the subjectivity of the case study and to avoid misinterpretations, the interviews were conducted by both researchers (Ryan et al., 2002). As group interviews have been performed, it is further important to have in mind that the respondents’ answers can be influenced by the presence of a co-worker, and that one part can dominate over the other (Collis and Hussey, 2014). However, in this research we have not experienced that this has occurred. The group interviews consisted of employees from the same organizational level, whom had close collaboration with each other.

The first step in the interview process was to perform a pre-interview. This in order to obtain reciprocity as described by Collis and Hussey (2014), thus finding a relevant research subject where mutual benefit of us as researchers and the participants can be obtained that enhances collaboration. More specifically, we believed that more elaborated information could potentially be obtained if the sample organization can benefit from the participation, which subsequently might favor both parts.

### 3.4.1.1 SELECTION OF RESPONDENTS

In order to understand how LF Bank manages risks at multiple organizational levels, and how the bank is affected by regulatory pressures, we have performed interviews with respondents from different organizational levels that possess different organizational roles. At the pre-interview we suggested a number of organizational roles that we found relevant to interview. The respondent from the pre-interview has a holistic understanding of the organization with insight from both the central function and the practitioners on local level, and provided us with contact information to appropriate and relevant respondents to interview. The table below illustrates which organizational roles the respondents possess:

<table>
<thead>
<tr>
<th>Respondents</th>
</tr>
</thead>
<tbody>
<tr>
<td>Credit manager</td>
</tr>
<tr>
<td>Governance officer (and former CRO)</td>
</tr>
<tr>
<td>Bank manager</td>
</tr>
<tr>
<td>Assisting bank manager</td>
</tr>
<tr>
<td>Compliance officer</td>
</tr>
<tr>
<td>Risk controller</td>
</tr>
<tr>
<td>Office manager</td>
</tr>
<tr>
<td>Advisor</td>
</tr>
<tr>
<td>Bank support</td>
</tr>
</tbody>
</table>

*Table 1: Interview respondents*
When the material from the interviews was compiled, we realized that additional interviews on the operational level of LF Bank should have been performed. This in order to study how the administrative burden required by the stricter banking regulations is handled by employees at the lower level of the bank. The research findings now illustrate that the employees working at operational level to some degree are dissatisfied with the tougher administrative routines, but also an overall happiness among the employees. We therefore believe that additional interviews on the operational level would have strengthened the research findings.

3.4.1.2 INTERVIEW PROCESS

As illustrated in Table 2, six interviews were conducted with nine respondents. Five interviews were conducted face-to-face and one by telephone. Three interviews were with one respondent, and three interviews were conducted with two respondents present, as per the respondents’ own request.

<table>
<thead>
<tr>
<th>Interview</th>
<th>Organizational role</th>
<th>Interview date</th>
<th>Interview type</th>
</tr>
</thead>
<tbody>
<tr>
<td>1</td>
<td>Credit manager</td>
<td>4/3-15</td>
<td>Face-to-face</td>
</tr>
<tr>
<td>2</td>
<td>Governance officer (former CRO)</td>
<td>26/3-15</td>
<td>Telephone</td>
</tr>
<tr>
<td>3</td>
<td>Bank manager + assisting bank manager</td>
<td>8/4-15</td>
<td>Face-to-face</td>
</tr>
<tr>
<td>4</td>
<td>Compliance officer + risk controller</td>
<td>14/4-15</td>
<td>Face-to-face</td>
</tr>
<tr>
<td>5</td>
<td>Office manager + advisor</td>
<td>16/4-15</td>
<td>Face-to-face</td>
</tr>
<tr>
<td>6</td>
<td>Bank support</td>
<td>4/5-15</td>
<td>Face-to-face</td>
</tr>
</tbody>
</table>

Table 2: Interview sequence

The first interview, the pre-interview, was performed with the local credit manager, also part of the local management team, the banking support function, and local credit committee of one of Länsförsäkringar’s regional insurance companies. The second interview was conducted with the governance officer at the legal entity. This respondent is LF Bank’s former Chief Risk Officer and was previously part of the bank’s management team. The third interview was conducted with the bank manager and the assistant bank manager of one of Länsförsäkringar’s regional insurance companies. The fourth interview was conducted with the local compliance officer and the local risk controller of Länsförsäkringar’s regional insurance companies control function. The fifth interview was performed with one office manager and one advisor at the operational level, whom have direct customer contact. The sixth interview was conducted with a respondent working at the banking support function at one of Länsförsäkringar’s regional insurance companies, also part of the local credit committee.

Each respondent was contacted by email. As recommended by Kvale and Brinkmann (2009) a presentation of us as researchers and the research topic were communicated in order to clarify the purpose of the study and give the respondent an overview of the study. In addition, this gave the respondents an opportunity to become familiar with the research area, which subsequently could make the respondent feel more comfortable and prepared. Sending the
presentation in advance further gave more time to focus on the interview questions during the interviews, and increased the possibility to receive richer information. Thereafter, date, time and place for the interviews were settled.

Our roles were similar to what Ryan et al. (2002) describe as “visitor” (p. 152). This means that we visited the case site to conduct the interviews, except for the telephone interview. The advantage of the visiting approach is that the respondents can be expected to feel more comfortable. The interviews lasted on average one hour and have been recorded using a Dictaphone after permission by the respondents. The Dictaphone was useful to facilitate the transcription of the interviews and the subsequent data analysis (Trost, 2010). Recording of the interviews further enabled us to pay full attention to the topic and the information exchange during the interview and thus enabled higher quality of the interview being achieved (Kvale & Brinkmann, 2009; Trost, 2010). As suggested by Ryan et al. (2002) keywords were noted during the interviews in order to discuss and reflect the interview afterwards. To avoid that the respondents felt uncomfortable by being outnumbered (two interviewers and one interviewee), one of us was responsible for asking questions, and the other one for taking notes (Trost, 2010).

3.4.1.3 INTERVIEW GUIDE

An interview guide (see Appendix 1) was constructed and used during the interviews. Before preparing the questions, secondary data was collected in order to increase the understanding of the sample organization. This enabled formulation of appropriate interview questions, and increased the quality of the interviews as we become more prepared. Since the interviews were semi-structured, the interview questions were of open character (Trost, 2010) and prepared in advance (Collis & Hussey, 2014). This facilitated the process in making them clear and concrete in order to avoid misunderstandings, which Silverman (2011) emphasizes is one of the risks when conducting interviews. In accordance with Collis and Hussey (2014) it further enabled more developed answers. The interview questions were further specific, simple and straightforward. However, the introductory questions were less specified in order for the respondents to get comfortable in their role. Furthermore, as recommended by Brinkmann and Kvale (2015) and Trost (2010), neutral question were formulated and leading questions avoided in order to not influence the respondents answers. The interview guide was infused by theory. The questions were categorized into Risk management, Control perspective and Ownership-structure.

In order to receive answers that provide a broad view of the same issues, the respondents were to a large extent asked similar questions. However, when forming the questions, considerations were given to each respondent's assumed level of knowledge and background in order to have the same meaning for the respondents (Kvale & Brinkmann, 2009). The sequence of questions and follow-up questions were based on the respondent's' previous answers in order for the interviews to proceed appropriately (Trost, 2010). Examples of follow-up questions that were used are: “How do you mean?” and “Can you please exemplify.” To enhance the quality of the interviews, the interview guide has been carefully read before each interview in order for us to be prepared (Trost, 2010).
3.4.2 SECONDARY DATA

In order to prepare for the interviews and to find the focus area in the research, information from LF Bank’s website and annual reports were collected. This contributed with a holistic overview of the organization and revealed key points in how the organization wants to be perceived and what events they believe are of importance. As noted by Collis and Hussey (2014) it also enhanced the interpretations of the interviews. In addition, internal documents provided by the respondents from LF Bank have been used.

Since annual reports are produced for the external readers and therefore not always provide a truthful view of reality, these documents have been analyzed with awareness of their lack in neutrality and transparency, as recommended by Collis & Hussey (2014) and Silverman (2011). Furthermore, the data from the annual reports has been related to the data from the interviews and internal documents in order to make sense (Silverman, 2011). Internal documents have been of interest as they are not produced for the external public and could therefore be assumed to contain information of other character.

3.5 METHOD FOR DATA ANALYSIS

Before conducting the interviews and forming the interview guide, we selected our data analysis method. This is in accordance with Kvale and Brinkmann (2009) who argue that selecting the data analysis method prior to the data collection will facilitate the data analysis. The first step in the data analysis was to transcribe the collected interview data into written documents in order to get an overview of the information and become familiar with the material. Reflections that arose during the transcription process were separately noted in the document. Furthermore, as recommended by Kvale and Brinkmann (2009), rules were set before transcribing the material in order to obtain consistency in the written language and produce comparable material, such as only transcribing what is clear and distinct to minimize the space of different interpretations.

The second step was to reduce the amount of information collected from each data source, whereby solely relevant data was selected. The selected data was then studied multiple times in order to code and subsequently structure the data into categories based on the developed frame of reference. This method was, in line with Kvale and Brinkmann (2009) and Collis and Hussey (2014), chosen to get an overview of the massive transcribed material. The material was then reviewed in order to identify interesting notions including themes, phrases and patterns. This data comprises the empirical material of the research. As recommended by Trost (2010) quotations in the empirical chapter have been converted from spoken language to written language.

3.6 ETHICAL ISSUES

When performing case study research, ethical issues arise as confidential information is provided by the sample organization (Ryan et al., 2002). In this research, ethical issues are of significant importance as interviews have been conducted with respondents at several
organizational levels. This since respondents at lower levels might find it uncomfortable to express opinions that employees at higher levels subsequently can get access to. These issues have been carefully considered throughout the research process. To handle ethical issues, the research purpose and voluntary participation have been communicated to the respondents, as recommended by Collis & Hussey, (2014) and Kvale & Brinkmann (2009). Anonymity and confidentiality have furthermore been offered to the sample organization and each individual respondent. In addition, we have signed a confidentiality agreement as this was requested by the sample organization. Finally, the respondents were offered to read and express their opinions concerning the interview material before publishing the results, to assure that the research data was interpreted correctly and offer the respondents the possibility to deselect sensitive information. Altogether, the aim has been to minimize the risk of harm for the sample organization and the respondents.
4. EMPIRICAL MATERIAL

This chapter presents the empirical material collected. It presents LF Bank, the bank’s risk management and how the bank has been affected by regulatory pressures. The material is based on interviews, internal documents and publicly available documents.

4.1 LF BANK: A CUSTOMER-OWNED BANK

LF Bank was established in the year of 1996. The bank is owned by Länsförsäkringar AB, which is owned by 23 regional customer owned insurance companies, all forming Länsförsäkringar Alliance (see Figure 1). Hence, LF Bank is owned by their customers. The bank solely operates on the Swedish banking market, which enables local customer- and market knowledge. Today the bank is Sweden’s fifth largest retail bank with approximately 927,000 customers. Banking services are primarily provided to private individuals and agricultural customers through the 128 branches of the regional insurance companies, digital services and telephone.

Figure 1: Organizational chart of Länsförsäkringar

The legal entity, LF Bank, has the bank charter and is therefore ultimately responsible for the banking operations. The bank has three subsidiaries: Länsförsäkringar Hypotek AB, Wasa Kredit AB and Länsförsäkringar Fondförvaltning AB. Together they comprise the Bank Group of Länsförsäkringar Alliance.
LF Bank has a cooperation agreement with the 23 regional insurance companies, which through their local offices distribute the banking products and have the customer contact (see Figure 1). Each regional insurance company operates locally with their own CEO, management team, compliance and risk control. Most business decisions are taken at a local level. The bank strives to work on the basis that the local offices perceive themselves as independent, managing their own bank and make the final decisions when they meet the customers.

LF Bank’s strategy is to provide banking services to Länsförsäkringar Alliance’s large customer base. The strategy is built on the brand of Länsförsäkringar and the regional insurance companies’ local customer and market knowledge. The bank strives to achieve a banking business with quality and customer value combined with healthy profitability. The objective is to keep growing in volumes and profitability, have the most prominent customer satisfaction and to strengthen the number of customers that use both banking- and insurance services, while maintaining a low risk.

In order to act in line with the interests of the customers, each regional insurance company appoints a council group that represents the company and has contact with both the customers and the insurance company. The regional insurance company interviewed has over 70 representatives that are part of the council to represent all the customers, appointed by the customers at council meetings. The customers are influential on both central level and local level. The customer representatives in the council meet the Board quarterly and participate in the general meeting. In addition, the office managers meets the council on a regular basis to find out the customers interests. To further ensure that the interest of the customer not fall behind other interests, there is no variable compensation within the bank. This to prevent employees from selling a particular product over another.

LF Bank is built on customer satisfaction, whereby it steers the entire organization. The bank manager explains that during the start-up years of the bank, the chairman of that time said at each board meeting “we have to think about the fact that we are a customer-owned bank.” The principles of customer-ownership are communicated throughout the entire organization, whereby employees at all organizational levels become conscious of this. The bank is successful with regards to customer satisfaction. According to Swedish Quality Index (SQI), LF Bank currently has, compared to the major banks in, the best customer satisfaction in Sweden. Factors such as availability and quick decision-making are highlighted to explain their high customer-satisfaction. The bank’s structure with 23 regional insurance companies and many offices across the country enables them to get access to the customers.

According to the credit manager, the advisors are the most important employees within the organization as they have the contact with the customer. Customer service is emphasized as important for the customer satisfaction. Trust is further considered to be an important factor, for instance, when customers place money in the bank, they should trust that the bank is safe.

“As we are customer-owned, it is incredibly important that we have the highest trust from the customers.” (Governance officer, LF Bank).
The respondent from bank support describes that the principles of customer-ownership implies that the bank is striving to offer the best customer protection among the banks in Sweden. According to the bank manager, the bank has achieved this goal. Over the years, the bank has recruited employees from other banks with extensive experience. The credit manager believes this to be positive for their credibility of the advisory services, which is highlighted as decisive for the customer satisfaction.

4.2 RISK MANAGEMENT IN LF BANK

4.2.1 RISK PROFILE

Based on the interviews it is highlighted that LF Bank’s customer-ownership influences their risk management. As LF Bank is owned by their customers, the bank strives to be risk averse and has chosen to have a low risk appetite. The lower risk here is taken as the bank is based on deposit from the customers. The principles of customer ownership imply that the organization is built on maximization of customer value rather than shareholder value. The primarily goal is therefore not to maximize the profit to be able to develop dividends to the shareholders. Several respondents highlight that this imply that the bank is able to work from a long-term perspective. The bank manager argues that the bank’s decisions potentially not are as short-term as in other banks, whom might increase the risk in order to be able to give the shareholders a good return. The risk controller believes their long-term behavior to be good from a risk management perspective. He states that the bank can be fairly well capitalized without their owners complaining, whereby they do not need to work on the margins with their capital. LF Bank’s lower risk profile imply that return on equity is lower than at some larger banks.

“We have no shareholders who are breathing down our neck, asking for maximum dividend.”

(Governance officer, LF Bank).

LF Bank's lower risk profile is reflected in their lending portfolio which mainly is directed towards private persons’ mortgages and family-owned farming and agricultural businesses. This strategy was settled in the year of 2000. The bank has low corporate credits, primarily distributed to small companies, and is careful to make sure that no single engagements become too big. Compared to the four large commercial banks in Sweden, LF Bank’s risk profile differs mainly as their loan portfolio is more heavily weighted towards the retail segment, which traditionally has been considered as less risky than the corporate segment. According to the governance officer, the other four big banks have a different risk-profile as they for instance have corporate finance, global lending, commercial lending, and lending to private equity companies. LF Bank solely operates on the Swedish market, and lending to commercial properties is in contrast to other banks a small part of the business. Several of the respondents argue that the bank’s lending structure can explain why the bank was less affected by the financial crisis.
4.2.2 RISKS

The bank is exposed to several different risks. The Bank Group identifies credit risk, market risk, liquidity risk, business risk and operational risk as the major risks. Credit risk arises when the bank’s counterparts cannot carry out its obligations. Credit risk was described by the respondents as the largest risk within the bank, especially because credit losses can have a major impact on the result of the business. Market risk is embedded in the credit risk, since changing factors on the market such as higher interest rate, could result in customers having difficulties to meet their payments. According to the office manager, credit risk holds two aspects. One aspect is to review the customer risk, looking at each individual. The other aspect is to review the total risk for the entire company. The advisor explains that the credit risk is embedded in the customer risk, which subsequently affects the capital risk as it is needed to hold capital in order to cover for potential defaults.

From a legal perspective, compliance risk can arise from two perspectives. Firstly, not achieving regulatory compliance can result in sanctions from FI. Secondly, the bank could be perceived as unprofessional, which subsequently could lead to reputational risks and loss of customers. Hence, the bank continuously aims to maintain good quality as the opposite can result in bad publicity, which could lead to the bank being unable to conduct business.

The bank is exposed to several operational risks, including personnel risk, customer risk, system risk, poor management and internal control, internal- and external frauds, and systematic risks. For example, risks can occur when personnel do not act correctly or when money laundering is not handled correctly. These operational risks arise both in the Bank Group and at the regional insurance companies. It is highlighted that the operational risks are important and challenging:

“When it comes to operational risks there is no limit of the exposure, it [operational risk] can be any amount” (Governance officer, LF Bank).

4.3 LF BANK’S RISK MANAGEMENT SYSTEM

In LF Bank, clear governance documents and policies are settled by the Board of Directors, which apply to all 23 regional insurance companies. The bank has created a new risk management system to capture all risks except the credit risks, which are managed separately. The bank aims to constantly identify, manage and evaluate all potential and existing risks. Several risk mitigation techniques are therefore applied by the Bank Group.

The bank is working with risk management at three levels, defined as the three lines of defense. The first line is the operations and refers to all risk management-activities executed by the employees in their daily work. The office managers are responsible for evaluating that employees act in line with the established directives and working instructions. This is further a responsibility of the banking support function, which reviews the work of the office managers. The second line is the risk control and compliance function, which on a more general level attempt to get a comprehensive view of the risk management system. The regulations require these functions to be independent by not being part of the daily operations
and business-decisions. They should report directly to the CEO and the Board. The control function does not really have any formal role in the bank as they are solely employed in the regional insurance company. Therefore, the risk controller and compliance officer are solely involved in the bank’s risk management concerning basic matters, such as advisory documentations. The risk controller argues that it has to be structured like this since the bank would not be able to have the banking charter if not having control over the risk management. Finally, the third line is the internal audit, which is a central independent function that examines the efficiency of the risk management system.

**Figure 2: LF Bank’s three lines of defense**

In order to regularly evaluate risks, LF Bank works with key controls and self-controls. These controls constitute the basis for controlling the daily operations and thereby ensuring that the quality is maintained. Key controls involve advisory documentations and customer knowledge. The bank has for instance customer-knowledge scripts comprising several questions settled by the central level of the bank. The scripts vary with the type and size of the transaction, which determines how extensive customer-knowledge that is required. In order to meet the money laundering regulations, these customer-knowledge scripts were previously performed manually, however these have been integrated into the IT-system, implying that transactions cannot proceed unless the scripts are complete. Self-controls are used to monitor that each office manager is observing all activities at their offices. This by signing documents, confirming that all deposit-, withdrawal- and payment receipts, and duality of payments are controlled. An analysis of the material is then performed, which is followed up by the bank manager to ensure that the risk policy is being met. To control the investment advisory services, three consulting documents of each advisor are reviewed each month and classified in different categories. The purpose of the self-controls is to make proactive improvements.

The bank further carries out internal training and competence days in order to develop and maintain the competence among the advisors. In addition, LF Bank requires their advisors to have SwedSec-license, which is a license that applies to firms in the securities market that are under the supervision of FI. The license is intended to function as a quality measure for the
advisors and to ensure that they have the appropriate competence by performing trainings programs. The bank further has a mortgage license which implies a quality mark for the advisors’ knowledge and their advising. The license was introduced one year ago, being first among the banks in Sweden, and is today a regulatory requirement. Moreover, LF Bank has developed detailed role descriptions which are communicated throughout the organization, where each employee has to confirm reading and understanding the information.

LF Bank must consistently ensure that the bank has enough capital to cover potential risks, and a certain capital buffer. The bank therefore has a capital planning process called ICAAP (Internal Capital Adequacy Assessment Process), which involves a forward-looking assessment of how the capital adequacy is expected to develop by studying how all risks evolve over a three-year period. In addition, the bank has management meetings every second month, during which various risk analyses are conducted, including, the reporting of credit risks, abnormal interest rates and if employees compromised the operational risk which could constitute the basis for a warning.

4.3.1 CREDIT RISKS

LF Bank has a central framework for credits, settled by the bank’s Board, which determines how the framework should be applied. The employees at the central organization LF Bank are responsible for ensuring that everyone acts in accordance with the framework. In addition, the bank has a back office bank called BOB, which is a centrally appointed group responsible for handling loan documents, disbursing loans and ensuring quality of loan documents to minimize the credit risk. BOB is responsible for ensuring compliance with the regulations and the internal policies, and that the advisors do not exceed their mandate. Thus, the function ensures that all the formal requirements are fulfilled. The work at BOB is followed up monthly, whereby the bank manager is continuously updated.

LF Bank strives to have a careful credit assessment and therefore work a lot with credit quality. The decision-making process is characterized by duality as a system is involved when approving mortgages and making the disbursement. The bank uses a system called Kredirect (KRE) which gives a credit reference of the customer and divides the customers into PD-classes. The system thereby helps to score the customer and suggests an interest rate and a price, which further set the base for the advisors’ own assessment. The KRE system is together with the credit record used to manage the customer risk and to obtain an overall picture of the customer. However, these systems do not cover all parameters, which is why an individual judgment based on the settled credit policy is required. In addition, the system is used to monitor the employees’ risk-taking behavior.

The bank has different employee mandates at different credit levels. In total, there are four mandates: the advisor level, local credit committee, central credit committee, and the Board of Directors. Factors such as the size and type of the credit, and employee experience, determine where decisions are processed. Thus, credit risk provides a basis for the employees' mandates. The local credit manager decides the limit of the advisors' mandates by investigating each advisor's experience and level of knowledge, after a dialogue with the office manager and
approval by the central credit committee. As the regional insurance companies have their own local credit manager, the credit manager knows all the advisors and talks with them in person before deciding their level of limits. Thus, personal judgments are included and there are short distances between the levels within the organization concerning credits. The advisor believes this close personnel contact to be rather unique for the bank, which could be a consequence of not being as centralized as the bigger banks. Lastly, LF Bank has the final decision and provides the mandates. By using the system Kredirect it is possible to follow each advisor when making a credit application, which further constitutes a basis for giving higher mandates. Additionally, the advisors receive feedback regarding credits from the internal auditors, as well from the BOB. There are further goals set for the number of error cases allowed per month. If these goals are not achieved, adjustments are made.

With regards to credit granting, LF Bank’s risk management is based on several different risk elements. Many factors are considered, including the kind of credit, the borrower, the product, and the security. To reduce credit risk, the bank has a limit on the loan-to-value. The limit for mortgages is to borrow 85 percent of the value of the property. Additionally, an amortization is added and higher price taken for the mortgage that lies between 75-85 percent. Moreover, with regards to industrial premises, the bank has a lower loan-to-value ratio. This as the value of industrial premises partly lies in the performed business. To further control credit risks, the bank is making manual controls by studying for example lists revealing customers that are lagging in payment and lists showing abnormal interest rates. In addition, the loan portfolio is stretched by making scenario analyzes. For instance, in order to study loan commitments that might fail in the case of a rising interest rate, a scenario analysis where the interest rate is rising from for example seven to ten percent is performed.

4.3.2 OPERATIONAL RISKS

In order to control operational risks, LF Bank works with risk mitigation techniques, which include crises exercises and preparatory work. Internal control systems are implemented to prevent operational risks from occurring. For instance, when undesired events occur at the offices incident reporting should be performed, whereby the local level of the bank shall report to the central part of the bank as a part of their assessment of how risks evolve over time. The office managers are required to report if something beyond the daily routine occurs.

In order to control the employees performances, evaluation processes are continuously carried out both monthly and quarterly at several organizational levels. The office managers, the bank’s support function, the bank manager and LF Bank report their evaluations into the risk management system in order to develop and enhance the risk management procedures. For instance, spot-checks are carried out to control various advisors and their work. The office manager performs such checks on a monthly basis, looking at, for example, advisor documentations, attestations and disbursements. In addition, the internal auditors visit the office sporadically, checking the verification documents, lists and secrecy in order to ensure that routines are being followed. Moreover, different system backups are available to handle the system risk.
Once a year, the bank performs a large-scale risk analysis of the operational risks in order to identify high-risk areas. This is done by distributing a questionnaire comprising of about 100 questions with four alternatives, to each regional insurance company for them to assess their operational risks. Areas of concern include personnel, credit regulations and the office managers' performance. The final analysis is then collected and compiled by the Bank Group in order to get an aggregated value and study whether the risk picture has changed in relation to previous years.

4.4 LF BANK AND REGULATIONS

LF Bank highlights that they are strictly regulated and that the regulations have become increasingly strict after the latest financial crisis. New rules and directives are introduced by FI, and the bank must adapt to ensure that they comply with the requirements. Regulatory compliance is constantly monitored by FI. LF Bank’s working instructions are primarily based on laws and regulations. The bank manager highlights that the bank continuously complies with the requirements from FI. One key reason for the bank to ensure compliance at all times is the vision to have a banking business with quality and customer value combined with healthy profitability.

The local compliance officer, working at the regional insurance company, has the assignment to ensure regulatory compliance within the regional insurance company. This involves coordination of policies, directives and governance documents within the organization. The compliance officer primarily focus on the insurance business, but also serves the function as LF banks extended arm by giving local support for the compliance officer at the central level of LF Bank. Thereby, the major part of education and implementation of banking regulations is handled by the central level of LF Bank. Concerning banking regulations, the employees within the bank should according to the compliance officer, all be the experts. This is in line with the bank manager who states that he is responsible for regulatory compliance. The respondent from bank support is also responsible for regulatory compliance, in the area of advisory services documentations.

When new directives are introduced, these are interpreted by the employees at the central organization LF Bank, whom creates instructions based on the directives. Thereafter a group meeting is organized to discuss how these instructions are about to be communicated throughout the organization. The group consists of five bank managers, one quality manager and one advisor from compliance. Subsequently, the instructions are communicated to all bank managers, whom are responsible for distributing the information throughout their offices. The bank further has several channels for communicating information across the organization. Employees from the banking support function visit the offices to inform about new regulations and new working routines. Additionally, information is placed at the bank's intranet and regularly telephone meetings carried out.
4.4.1 CONSEQUENCES OF REGULATORY PRESSURES

The risk controller explains that a stricter regulation implies that one have to do everything more carefully, which also means less freedom to structure the work, i.e. one is forced to organize activities in a more formal way. The respondents highlight that stricter regulations have resulted in increased controls and tougher evaluation requirements. In essence, the regulations are affecting the whole organization substantially. One of the key risks emphasized by the regulators is operational risk, and LF Bank’s processes for managing operational risk have become more substantive and structured. Credit risk is another risk that is closely monitored by FI, as they require monthly reports of the credit risks. Credits that is about to become poor or have defaulted receive more attention and a number of new credit checks have been added to the business processes within the group. Moreover, the result of the bank’s capital planning process (ICAAP), has to be reported to FI.

In order to comply with regulatory requirements, various functions and key roles have been introduced at the bank. For instance, the Chief Risk Officer who is responsible for ensuring that all risks are identified, measured, assessed and reported was introduced in 2007. The compliance officer role was introduced in 2005, when FI implemented a regulation related to management and control (FFS 2005:1). As the regulations have increased the requirements of competence, the introduction of new regulatory directives is followed by internal training.

The regulations require increased capital holding. In the past, the regulations required an capital holding of 2 percent, which today has risen to 14.5 percent. LF Bank strives to have an capital holding greater than 14.5 percent to make sure that the bank is well above the minimum threshold. The bank manager explained that when the bank started, nobody perceived higher capital-rates as necessary, but by studying other European countries it shows that stricter regulations concerning the capital has been beneficial, which subsequently is protecting the customers. To further protect the customers, LF Bank must regularly transfer money to a stability fund introduced by the Swedish National Debt Office, with the purpose to help financing the state deposit guarantee and in other ways supporting credit institutions (Riksgälden, 2015).

The EU-directives have strict requirements and emphasize the importance of customer protection and consumer friendliness. For instance, there are higher requirements to provide the customers with information concerning mortgages, borrowing and interest rate setting. FI has strict requirements when it comes to advisory documentation, for example which questions to ask in order to get a comprehensive customer analysis. The advisory documentation was introduced in 2004 and FI has sanctioned banks that not follow the directives. The bank has a zero tolerance towards not performing advisory documentations correctly. The compliance officer highlights the importance of getting an adequate background of the customer. This involves that the customers’ risk levels are evaluated, whereby the customers have to share their experience of financial products and investments, their risk profile, investment horizon and so on. The documents show the customers’ current situation; from which the advisors should provide suitable recommendations. The advisors are further required to advise against decisions and actions that are considered as inappropriate.
for the customer. The advisory documentations are primarily used in order to protect the customers, whereby one should be able to recreate the advisory service session when studying a documentation at a later stage. LF Bank has strived to develop the advisory documentations. The bank plans to transform the advisory documentations from being executed manually to becoming integrated into the systems. This means that they will become an integrated non-optional part of the advisory routine, which cannot be avoided by the advisors.

FI has increased the requirements regarding customer knowledge, which has led to an increased number of controls concerning money laundering. The regulatory framework regarding money laundering is strict with clear guidelines and instructions for how to attain customer knowledge in a customer meeting. Based on the interviews, these instructions lead to questions that sometimes are perceived as intrusive by the customers. It is therefore important to keep a dialogue with the customers and explain that regulations require the employees to ask questions in order to attain customer knowledge.

The work with reporting increases constantly within the bank. The credit manager asserted that there are probably few industries that are so heavily controlled, in addition to the strict regulation, as the banking industry. This means that there are many things to keep track of. The compliance officer explains that they constantly work from a view “if it is not documented, it does not exist”. She argues that in order to achieve traceability, one constantly have to perform documentation and controls, one have to be able to go back and study the basis for decisions and actions in the past.

According to the bank manager and the assistant bank manager, stricter regulations were perceived as troublesome by the advisors before appropriate supporting systems were established. This as the employees found the heavier administration as time consuming. This is in turn confirmed by the advisor who argues that the there has been a greater workload in recent years because of the regulations as there are more steps to go through, since the internal routines are reinforced. According to the advisor, these changes have also been executed rather quickly. He explains that time and resources must be devoted in order to comply with the regulations, which could lead to less time with the customers. However, according to the office manager, the customer satisfaction does not seem to be negatively affected by the regulations. He explains that the number of customer complaints is low. The credit manager believes it is admirable what many advisors keep up with and accomplish, and argues that the advisors possess a difficult role as they are required to handle complex and comprehensive reporting requirements related to the advisory services, while also keeping up with the customer meetings. The increased workload cannot interfere with the quality of the customer meetings nor can it affect the volumes that the advisors bring to the bank.

The assistant bank manager argues that they are now starting to catch up with the system support, which means that the work performed by the advisors has been facilitated. This is confirmed by the respondent from bank support, who believes the support systems and working tools have improved substantially, which facilitates the work of the advisors. Another step that has been taken by the bank in order to manage the increased administrative burden has been to set up a Back Office Bank (BOB). The office manager argues that this
function is important to relieve some of the workload. The advisors are not forced to send the material to BOB, it is possible to go through with a mortgage on your own, but then the material will not receive a quality mark and the advisor becomes responsible for the formal requirements to be fulfilled. The advisor explains that he was initially resistant towards BOB since he thought it made intrusion on his mandate, but he has gradually become more positive to the function as it facilitates his work.

According to the advisor, they sometimes disagree on directives coming from higher instances within the organization. This occur when new directives requires new systems and working instructions to be implemented, whereby these have been developed without a dialogue with the users. Hence, there is a gap between theory and practice which is troublesome for the users as the systems and working tools are not adjusted to their way of working. This problem is also pointed out by the credit manager who argues that there can arise daily problems related to the directives set on central level and the assessment made on local level. He also argues that they usually agree in the end by discussing and jointly decide on a solution a little off the credit assessment. It is further possible for the advisors to communicate their opinions and make suggestions regarding the formation of the systems and working tools. The process for this starts at the office; a suggestion is presented for the credit- and bank manager at the regional insurance company; subsequently the credit- and bank manager present the suggestion at LF Bank’s board meeting. LF Bank is receptive for making changes as long as an underlying motivation is presented.

### 4.4.2 Interpretations of the Regulations

The risk controller believes the detail level of the regulations to be somewhat extreme. The credit manager argues that the employees within the bank sometimes view the stricter regulations after the financial crisis as a punishment. At the same time he acknowledges that these regulatory features are important to improve the financial system. The governance officer claims that one have to be humble and consider the introduced propositions as the regulations are intended to strengthen the banking system. The compliance officer is positive to management and control related to the regulations. She argues that it results in better control of the business, which in turn reduces the risks within the business. This is also noted by the bank manager who believes the increased documentation to facilitating the management of operational risks. The compliance officer further emphasizes that even though some employees are negative to all working instructions and governance documents, they complain when there is an area without any working instructions.

The risk controller argues that the implementation of a new regulatory framework is a way to spread knowledge about risk management. He therefore believes that the stricter regulations have made the bank managing risks better. This is confirmed by the office manager and the advisor, whom are both positive towards the regulations and believe that the assessment procedures have improved. Prior to regulation risk awareness increased with experience, but today risks are already defined and subsequently they are feasible to identify and analyze. The advisor further believes that the regulations help clarifying what the advisors are allowed to do, which reduces the insecurity among new employees. He argues that the customer
awareness has improved as a consequence of the stricter regulations, especially since new aids have been introduced. The bank manager claims that the office managers have become more experienced, and therefore are able to be more involved in the business activities. Partly as they receive feedback concerning the quality, but furthermore as they have documentations to rely on and follow. The assistant bank manager argues the local offices to have increased independency since stricter controls have been introduced, as it ensures correct actions. The office manager argues his office to be independent and the advisor does not perceive the regulations to have restricted his decision space. He explains that they have enough mandate to handle most of their credit cases since the office holds a lot of experience, whereby they rarely need help from the credit committee.

According to the governance officer, LF Bank has in contrast to other larger banks not been forced to lower their risk-profiles in order to fit the new view of the authorities. He further argues that the bank has not needed to perform big restructuring in order to go back to the core of banking, as they never left the basic in banking. This is also emphasized by the credit manager who does not think that the regulations introduced after the financial crisis have affected their risk management system that much. According to the compliance officer and the respondent from bank support, directives are often generally described, which means that there is space for how one choose to design and work with them in the business. The risk controller refers to the expression “comply or explain”. He describes that one can either strictly follow the regulatory design, or explain why one does differently, as long as FI is informed and one carefully document the procedures. He therefore believes how one handle matters is relatively free, at least within his area of responsibility.

The risk controller further explains that how one choose to implement a legal framework determine the use of it. He points out that one can fulfill a regulatory framework without managing risks particularly well as the regulatory frameworks not always are craftily drafted to cover everything. This is also highlighted by the compliance officer who argues that the implementation process, and whether the regulations are adapted to the reality, determines the use of them. It is highlighted as important to consider and communicate the bigger picture when it comes to the regulations, not just view them as requirements and understand why authorities impose regulations in a certain way. In LF Bank, respondents from all organizational levels emphasizes that the regulations are built on a care for the customers. The assistant bank manager states that it is of high importance to comply with the regulations as the bank is owned by its customers, since the regulatory purpose is to protect the customers. The bank manager further finds the situation to be beneficial as the bank is customer-owned. The bank manager explains that the bank had to make a choice of perceiving the situation of stricter regulations as “drowning in regulations” or “this is good as hell for our customers”. He argues as they have chosen the latter perception, the bank is gaining a competitive advantage. The assistant bank manager believes the bank has managed to turn the stricter regulations into something positive, which in the end is protecting them. She further emphasizes the importance of reminding the employees about the regulatory purpose when new regulatory directives are implemented. However, the compliance officer points out that one of the challenges within the control function is to get the employees within the
organization to understand the business benefits of the regulations. She argues that their daily challenge is to package the regulations to make them beneficial for all employees, and to make them understand the benefits of them.

4.4.3 SUMMARY OF CONSEQUENCES/INTERPRETATIONS OF THE REGULATIONS

In the table below, a summary of the consequences and interpretations of the regulations at multiple organizational levels is presented. This in order to demonstrate how the employees between the different levels reason concerning the regulatory pressures. The office manager and the advisor represent the office level. The local bank management level consists of the bank manager, the assistant bank manager, the credit manager and the respondent from bank support. The compliance officer and the risk controller represent the control function level. Finally, the governance officer represents the central level.

<table>
<thead>
<tr>
<th>Consequences/interpretations of the regulations</th>
<th>Office level</th>
<th>Local bank management level</th>
<th>Control function level</th>
<th>Central level</th>
</tr>
</thead>
<tbody>
<tr>
<td>Greater workload</td>
<td>No big effect on the RM-system</td>
<td>Better control and RM</td>
<td>No implications for the risk profile</td>
<td></td>
</tr>
<tr>
<td>Quick changes</td>
<td>Improve the financial system</td>
<td>Reduced risks</td>
<td>Not resulted in big restructurings</td>
<td></td>
</tr>
<tr>
<td>Systems and working tools not always adjusted to their way of working</td>
<td>Facilitated RM</td>
<td>Less freedom to structure the work</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Enhanced assessment</td>
<td>Increased knowledge</td>
<td>Detail level somewhat extreme</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Clarified roles</td>
<td>Increased mandates on local level</td>
<td>Room for adaption</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Improved customer awareness</td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>No restriction of decision space</td>
<td></td>
<td></td>
<td></td>
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</tr>
</tbody>
</table>

*Table 3: Consequences/interpretations of the regulations on different levels in LF Bank*
5. ANALYSIS

This chapter analyses the empirical material in relation to the frame of reference.

5.1 LF BANK’S MANAGEMENT OF RISKS AT MULTIPLE ORGANIZATIONAL LEVELS

Studying the research results, LF Bank’s customer-ownership is affecting their management of risks. Based on the interviews, it is clear that the customer-ownership makes the bank striving to have a low risk appetite. This as the bank is based on money from the customers. The strategy is to have a low risk profile, and the objective is to have operations based on low risk. This is in accordance with the contingency literature, where it is argued that ownership structure is one key variable that influences firms’ accounting systems. The respondents point out that the bank's customer-ownership has a positive influence on their risk management. They are not pressured to maximize the profit in order to develop short-term financial gains to shareholders, which enables the bank to act from a long-term perspective. This is in line with Ayadi et al. (2010) who argue that customer-owned banks not are as pressured to maximize profit in order to provide dividends to shareholders, and therefore are more long-term oriented than shareholder-owned banks.

In LF Bank, risk management is an area of responsibility at office level, bank management level, control function level and central level. Risk management activities are therefore performed at multiple organizational levels. This is illustrated by the bank’s three lines of defense; operations, risk control and compliance function, and internal audit. Risk management has become integrated into the management control system. The bank uses both action-, results-, personnel- and culture controls, as defined by Merchant (1982) and Merchant and Van der Stede (2007), to ensure that employees act in line with the settled risk policy. Action controls are used to directly control employees’ actions and decisions by implementing work rules, policies and procedures, and behavioral constraints. Clear governance documents, policies and working instructions are settled by the bank, and internal control systems are implemented. For instance, a supporting system requiring duality is used in the decision-making process for credit granting. In addition, the employees have to perform mandatory advisory documentations and customer scripts to obtain customer knowledge. Results controls are used by performing regularly evaluation processes at several organizational levels, whereby risks are continuously measured. For instance, an annually profound risk analysis of the operational risks is carried out in order to identify high-risk areas, and employees performances are evaluated by carrying out spot-checks. The bank further uses personnel controls to control how risks are managed across the organization by communicating clear role descriptions, carrying out internal training and competence days, and requiring the employees to be licensed. Several information channels are further used to enhance the internal communication. LF Bank also works with culture controls to indirectly control the employees’ risk-taking behavior by creating behavioral norms based on the principles of customer-ownership. During the bank's start-up years the chairman repeatedly reminded the employees of the bank being customer-owned. The research findings illustrate that the respondents claim that the bank's risk management processes are effective. The employees constantly keep in mind the importance of the customers and them being
protected, which a low-risk taking behaviour contributes to. Hence, it seems that the bank has managed to create a risk management culture within the organization, as defined by Arena et al. (2010), which further is a sign that their risk management has become effective.

Having the above-mentioned in mind, it could be argued that the ERM approach has been adopted within LF Bank. The bank views risk management as an important and integrated element in the performed business activities rather than an externalized compliance function. Risk management has been correlated with business strategy and objective-setting, whereby it has become a part of senior managements’ daily work. This integrated work approach might be an explanation for why LF Bank managed the financial crisis successfully. As Kaplan and Mikes (2012) argue, lack of communication between risk managers and top management can explain why some banks failed during the financial crisis. More specifically, it could be considered that the bank is working with risk management in accordance with Mikes’ (2009) ideal RM type defined holistic risk management. The bank is managing both quantifiable and non-quantifiable risks in their risk management system including credit risk, operational risk and compliance risk. Reputational risk is highlighted as important since they are customer-owned. The bank further performs scenario analyses and an annual profound risk analysis of the operational risks in order to identify high-risk areas. In addition, risk management has received strategic significance within the bank.

It could be perceived that the management of risks in LF Bank is viewed as what Van der Stede (2011) describes as “personalized” and thus everyone’s responsibility. Risk management is emphasized to be a responsibility for all employees in order to create customer value and comply with regulations. In line with Mikes (2011) definition of “black boxing”, it could further be argued that risk management has got organizational significance within the bank. This as risk management practices are communicated as necessary to create customer value, but also unavoidable to act in line with the regulatory requirements.

5.2 THE EFFECTS OF REGULATORY PRESSURES IN LF BANK

5.2.1 REGULATORY PRESSURES: AN INSTITUTIONAL PERSPECTIVE

The research findings illustrate that FI put coercive pressure, as described by DiMaggio and Powell (1983), on LF Bank to change their risk management activities. FI has imposed stricter requirements for how to attain customer knowledge and how to perform advisory documentations. In addition, FI requires the bank to hold increased capital holdings and perform additional evaluation processes. LF Bank constantly must adapt to ensure that they comply with the new rules and directives. Based on the interviews, LF Bank adjust to the regulations for several reasons. The respondents believe the regulations to enhance the management of risks within the business. For instance, it is emphasized that the stricter requirements have resulted in increased risk awareness among the employees, enhanced assessment procedures, and better control of the business. It is further highlighted that the regulations increase the customer protection. The research findings also illustrate that LF Bank complies with regulations in order to not receive sanctions from FI. In addition, it is emphasized as important to act in line with the requirements from FI to have a banking
business with quality. The respondents point to the importance of earning trust from their customers and be perceived as professional and credible, in particular as they are owned by their customers. Having this in mind, it could be argued that LF Bank acts in line with the regulatory requirements in order to both enhance their risk management, and to gain legitimacy. Within the institutional literature, search for efficiency and legitimacy is argued to explain why organizations change and become more homogenous.

When LF Bank started, they did not perceive higher capital holding as necessary. However, the bank manager expresses that high capital holdings in other European countries has showed to be beneficial as it protect the customers. The bank even strives to have an capital holding above the minimum threshold. This imitating behavior can be related to DiMaggio & Powell’s (1983) mimetic isomorphism, as the bank imitates other successful and legitimate banks in Europe. Since LF Bank historically has been aiming to be risk averse as the bank is customer-owned, it could be argued that LF Bank might holds high equity rates in order to demonstrate that they want to protect their customers to gain public trust. According to Power (2009), banks can also choose to hold excess capital to obtain a good credit rating. The respondents highlight that they are positive to the regulations as they enhance the customer protection. However, they do not specify what the customers get protected from, more than that mechanically secured routines ensures correct actions among the employees during the customer meetings. Hence, it could be questioned whether the regulations actually have increased the customer protection in LF Bank, or if the bank have changed their internal procedures merely to comply with the regulation and enhance their legitimacy.

The concept of decoupling presented by Meyer and Rowan (1977) also appear when studying the role of the compliance officer introduced in 2005 as a response to regulatory directives. This role is responsible for ensuring regulatory compliance. However, the research findings illustrate that the compliance officer has a relatively limited knowledge of the banking regulations, and that the actual work with regulatory compliance is carried out by the employees within the bank. The compliance officer is employed by the regional insurance company and therefore primarily concerned with the regulations related to the insurance business. Although, the compliance officer is outwardly presented as ensuring regulatory compliance in both the bank and the insurance company and the bank. Thus, LF Bank is informally restructuring their activities to be able to comply with the standardized formal structures required by FI. It could be argued that the role as a compliance officer is added to the bank mostly to demonstrate that they comply with the regulatory requirements and hence gain legitimacy.

5.2.2 REGULATORY PRESSURES: A MANAGEMENT CONTROL PERSPECTIVE

LF Bank could be perceived as an decentralized organization as decisions primarily are taken at local level. Cummings (1995) describes that an organization is decentralized when important decision-making is made at lower organizational levels. The bank manager states that their aim is to work on the basis that the local offices perceive themselves as independent, managing their own bank, and make the final decisions when they meet the customers. Thus, the bank seems to be built on high autonomy and employee empowerment. This is in line with
Wahlström (2009) who claims that employee empowerment is important in decentralized organizations.

In LF Bank, regulatory pressures affect the whole organization substantially. Operational procedures have become more mechanically secured to make sure that they are performed during the customer meetings. In addition, an increased number of evaluation processes have to be carried out, and some of them regularly reported to FI. As the regulations have increased the requirements of competence, the employees are required to be licensed and regularly perform internal training. In short, the regulatory pressures have resulted in increased use of action-, results- and personnel controls, and increased administrative work. The research findings further illustrate that LF Bank’s organizational structure is affected by the increased control that the regulations have put forth. The regulations have, to some extent, required LF Bank to increase the centralization of the bank. For instance, a central back office bank has been set up, that among other things, ensures the quality of loan documents and that the advisors do not exceed their mandate. In addition, an increased number of evaluation processes are reported to the central level of the bank. This is in accordance with Merchant (1982) who argues that the design of the organizational structure can be affected by the controls used within a firm. To some extent, this also confirms Wahlström’s (2009) statement that Swedish banks have to adjust their management structures to adapt to the new regulations.

Wahlström (2009) points out that more centralized control and administration can become problematic in decentralized organizations as it differs from organizational traditions. He argues that it can result in reduced employee empowerment, and thus reduced commitment and motivation among the employees. However, the research findings do not illustrate that the increased centralization have led to reduced employee empowerment in LF Bank. The local offices have not got less decision authority as a result of the stricter regulations. The assistant bank manager even argues that the local offices have got more mandate. This since the competence level among the employees has increased, and internal control systems have been implemented that can ensure correct actions among the employees. The employee commitment being maintained within LF Bank could also be a consequence of the employees still including personal judgment in their decision making process. According to Wahlström (2013), the opposite, when relying on risk measures, could lead to reduced employee commitment. For example, the advisor explains that the PD classification system is a tool to help making a better judgment. In addition, the customer benefits of acting in line with the regulations are emphasized within the bank. It could therefore be argued that the organizational culture based on customer-ownership has made it easier to implement the regulations. As the bank manager states, the bank has chosen to perceive the situation of stricter regulations as “this is good as hell for our customers” rather than “drowning in regulations”. This is evident throughout the organization as the respondents from all organizational levels expresses that the regulations are of benefit for their customers. This consistent answer among the employees is in line with Merchant & Van der Stede’s (2007) description of having a strong organizational culture. In addition, internal communication seem to be a priority within LF Bank. When new directives are imposed, these are
communicated throughout the organization through a funneling process. It is further possible for local level employees to communicate with the central level and influence their work.

The increased focus of risk management and ERM has resulted in changing work tasks and new professions in LF Bank, a consequence that is highlighted within the risk management literature. The stricter regulations have required the bank to introduce new roles including the Chief Risk Officer and compliance officer. The bank’s Board has further been required to settle new policies and implement new risk management systems and working instructions to comply with regulatory requirements. Risk management activities are further controlled by the risk control and compliance function, and the internal audit function, which independently report directly to the CEO and the Board.

The research findings demonstrate that employees at the operational level have perceived the regulations as more troublesome than employees at higher organizational levels. For instance, the governance officer working at the central level of the bank describes that the bank has not been forced to make big restructurings due to stricter regulations as they already have a low risk profile. However, the advisor believes that the regulations have led to heavier working routines. This is in line with Power (2009) who describes that stricter regulations have put a lot of pressure on the employees at operational levels. Although supporting systems and working tools have been developed that facilitates the work at the operational level, the advisor describes that there could arise a gap between theory and practice as they are not adjusted to their way of working. This is in accordance with Wahlström (2009) who explains that knowledge clashes between the staff could appear as they have different responsibilities and frame of references. This could describe why contradicting opinions towards the regulations exist between the organizational levels in LF Bank.
6. FINAL DISCUSSION

This chapter presents the concluding remarks. It furthermore discusses the contribution to the theory and literature, and provides a suggestion for further research.

6.1 CONCLUSIONS

In this section we will present our conclusions in order to answer the research question and fulfill the stated purpose. As a reminder, we aim to answer the following research question:

“How does a customer-owned bank manage risks at multiple organizational levels, and how is the bank affected by regulatory pressures?”

The research findings illustrate that LF Bank is practicing risk management in accordance with the ERM approach. Risk management has become correlated with business strategy, and an important element in the daily business to manage both quantifiable and non-quantifiable risks. The bank’s strategy is to have a low risk profile in order to prioritize the interests of the customers. Thus, the results show that the customer-ownership of LF Bank enables risk management to be aligned with strategic objectives. Risk management has therefore become integrated into the management control system. The bank uses both action control, results control, personnel control and culture control to make sure that the employees act in line with the set risk policy.

Studying the results, it is clear that LF Bank is affected by the regulatory pressures in several ways. The stricter regulations have led to increased centralized control and administration. However, the bank has managed to respond to the regulatory pressures successfully. The regulations have not led to reduced decision authority for the employees, and have therefore not reduced their motivation. This as the employee competence has increased and internal control systems have been implemented that can ensure correct actions among the employees. In addition, the principles of customer-ownership facilitate the implementation process of the stricter regulations. The positive perception of the regulations and the organizational culture based on customer value could be one reason for why the bank has succeeded in adopting their risk management system in line with regulatory requirements. The findings demonstrate that LF Bank adapts to the directives introduced by FI both in order to enhance their risk management and to gain legitimacy.

Based on the interviews, it seems like LF Bank historically have been striving to operate in line with the ERM approach. The strategy to have a low risk profile was settled before the financial crisis took place and stricter regulations were introduced. However, the research findings illustrate that LF Bank experiences a strong pressure to act in line with the legal requirements as they are owned by their customers. Having this in mind, we can conclude that LF Bank’s low risk appetite is embedded in their customer ownership, and not a consequence of stricter regulations.
6.2 THE CONTRIBUTION TO THE THEORY AND LITERATURE

This research gives a contribution to the research within the institutional- and contingency area. The research findings add an empirical example of how a customer-owned bank manages risks and how it is affected by regulatory pressures, and provide an example of institutional theory’s application. The provided insights could be relevant in other organizations that have to respond to similar institutional pressures. The results can further give insights to the research within the contingency area. We believe that the research findings are of relevance and use to formulate better hypotheses with regards to the meaning of customer-ownership for the use of risk management.

The research also gives a practical contribution to the literature within the risk management and management control area. We have responded to the research calls to study risk management from a management control view. The research findings contribute to the understanding of how risk management is practiced at multiple organizational levels in a customer-owned bank, and communicated within the organization. Furthermore, the results illustrate how the choice and use of ERM practices in a customer-owned bank are influenced by institutional pressures. More specifically, the understanding of the consequences of exposing a customer-owned bank to regulatory pressures is increased. This includes an enhanced perception of how working conditions and employee motivation are affected by regulations.

6.3 SUGGESTION FOR FUTURE RESEARCH

In this research, a single case study has been conducted to study how a customer-owned bank manages risks at multiple organizational levels and how the bank is affected by regulatory pressures. The research results illustrate that there are opportunities for further research within the research field. The findings demonstrate that the contingency variable customer-ownership has implications for how a customer-owned bank manages risks. In order to increase the understanding of the differences between how a customer-owned bank and a shareholder-owned bank manage risks and are affected by regulatory pressures, we suggest that a comparative case study is conducted in future research.


APPENDIX 1 - INTERVIEW GUIDE

Introduction
1. Please tell us a bit about your role and your work within the bank.

Risk management
1. Which risks would you describe the bank are exposed to?
2. Which risks would you describe are the most important for the bank?
3. How would you describe the bank's risk profile in relation to other banks?
4. How would you describe that the bank is working with risk management within the organization?
   - How do you perceive this has developed over time?

Regulations
5. How do you perceive that the bank's risk management has changed after the regulations have become stricter?
6. What do you think about the regulations?
   - How do you think the regulations are affecting the bank?

Control perspective
7. How would you describe that the bank is evaluating risks?
8. How would you describe that the employees risk-taking is being controlled?
9. How independent would you say that the local level of the bank is?
10. How would you describe the communication between central- and local level with regards to risk management?
11. Do you perceive that it can arise problems when new directives are implemented within the organization?
    - How do you believe this is handled within the organization?

Ownership-structure
12. How would you describe the bank's risk management to be influenced by the principles of customer-ownership?
13. Which customer values do you think are important to deliver?
14. Do you perceive that the regulations have affected the bank's possibilities to have satisfied customers? If yes, how?
15. Which influence would you describe the customers to have?

Ending
16. How would you describe the performance of the bank?
17. Is there something you would like to add?