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Trustworthiness in Banking: The Three Lines of Defense Model

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Submitted to the Program of Organizational Dynamics, College of Liberal and Professional Studies in the School of Arts and Sciences in Partial Fulfillment of the Requirements for the Degree of Master of Science in Organizational Dynamics at the University of Pennsylvania
Advisor: Kimberly Torres Ph.D.

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Abstract

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Keywords

Three Lines of Defense Model, banking industry, risk culture

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THE THREE LINES OF DEFENSE MODEL

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The objective of this research is to explore how the Three Lines of Defense Model ("the Model") can most effectively be leveraged by banking professionals to foster trustworthiness in the banking industry. The banking industry's trustworthiness—or untrustworthiness—has the power to positively or adversely impact the lives of individuals, and the power to enhance or diminish global economic stability (Dia, 2011; Egan, 2017; Financial Stability Board, 2010). This research presents an overview of the literature on the Model, and findings gathered from a confidential online survey, reflecting insights from 43 banking professionals with first-hand experience working within the Model. When implemented strategically by dedicated banking professionals, the Three Lines of Defense Model serves as a highly effective framework for fostering trustworthiness in the banking industry.

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CHAPTER 1: INTRODUCTION

The objective of this research is to explore how the Three Lines of Defense Model ("the Model") can most effectively be leveraged by banking professionals to foster trustworthiness in the banking industry. The industry's trustworthiness—or untrustworthiness—has the power to positively or adversely impact the lives of individuals, and the power to enhance or diminish global economic stability (Dia, 2011; Egan, 2017; Financial Stability Board, 2010). When implemented strategically by dedicated banking professionals, the Three Lines of Defense Model serves as a highly effective framework for fostering trustworthiness in the banking industry. I am personally drawn to this research because of my role in the Three Lines of Defense Model within a Global Systemically Important Bank ("G-SIB").

Roadmap

In this introduction, I define "trustworthiness," "Three Lines of Defense Model," and "G-SIB," while establishing an outline of my key research questions. In chapter two, An Overview of the Literature, I outline key findings from the literature on the Three Lines of Defense Model, including academic literature, industry white papers, and publications by industry regulators and standard-setters. In chapter three, Methodology, I detail my approach to designing a confidential online survey to gather first-hand insights from banking professionals with experience working within the Model. In chapter four, Data Analysis and Findings, I outline insights derived from quantitative and qualitative survey data. In chapter five, Conclusion, I aggregate key takeaways from this research and provide recommendations on how the Model can most effectively be leveraged by banking professionals to foster trustworthiness in the banking industry.

Trustworthiness

Within my research, I define “trustworthiness” as the presence of two essential characteristics: integrity and competence. I derived this definition of “trustworthiness” from “Uncertainty, Trust, and the Regulation of the Banking Industry” by Enzo Dia, published in the *International Review of Economics* in 2011. “Integrity” is defined by the Cambridge Dictionary as “the quality of being honest and having strong moral principles that you refuse to change.” (Stated in a straightforward manner: A bank that operates with “integrity” isn’t intentionally, lying, cheating, or stealing.) “Competence” is defined by the Cambridge Dictionary as the “ability to do something well.” Dia (2011) emphasizes that trustworthiness in the banking industry “does not simply mean the expectation of a low probability of being cheated, but a more far-reaching appreciation of the capabilities and knowledge of other cooperating agents” (p. 214). It’s not adequate for a bank to operate with integrity: The bank must also possess the competence to protect its customers from harm, such as loss of assets entrusted to the bank. Dia (2011) provides the example of “a very honest banker” who lacks the ability to successfully identify which potential borrowers it is reasonable to lend to, and therefore “cannot guarantee the safety that depositors require” (p. 217). Such a banker may have the highest integrity, however trustworthiness can only be achieved when integrity is paired with competence (Dia, 2011).

Research Questions

The objective of my research is to answer the following key questions:

- How can the Three Lines of Defense Model most effectively be leveraged by banking professionals to foster trustworthiness in the banking industry?
- What are the most common challenges banking professionals encounter with the Model, and how can those challenges most effectively be navigated?
- What is the Model's greatest strength, and how could that strength be fostered?
- What is the Model's greatest weakness, and how could that weaknesses be mitigated?

The next section provides an overview of the Three Lines of Defense Model.

Three Lines of Defense Model

While the Three Lines of Defense Model is ubiquitous in 21st century banking, "there is no consensus on how the three lines of defense concept entered the risk domain, with some theories suggesting military or sporting origins" (Davies & Zhivitskaya, 2018, p. 37). Davies and Zhivitskaya (2018) trace one of the earliest references to the Model back to a UK banking regulator, the Financial Service Authority, in 2003 (p. 37). Davies and Zhivitskaya (2018) define the objective of the three lines as defending "against the risk of corporate failure" and the adverse impact such failure would have on a bank's stakeholders (p. 40). A bank's stakeholders include clients, investors, vendors, and employees, all of whom would be adversely impacted by a bank's untrustworthy practices—however, the scope of adverse impact would not stop with the bank's immediate stakeholders. Each stakeholder has their own network of stakeholders—and those stakeholders have their own stakeholders, and so on—all of whom would feel the far-reaching ripple effects of a bank's untrustworthy practices. The Three Lines of Defense Model is regarded as an effective framework for fostering trustworthiness in the banking industry by standard-setters and regulators including the Basel Committee on Banking Supervision (BCBS), Financial Stability Board (FSB), Federal Reserve Bank ("the Fed"), and Office of the Comptroller of the Currency (OCC) (BCBS, 2011; FSB, 2015; Held, 2018; OCC, 2014). Professionals within each line of the Three Lines of Defense Model have a distinct role to play in driving trustworthiness in the banking industry.

First Line: Business Management

First line of defense professionals work within the "risk-taking and revenue-generating" area of the bank that provides services to clients (Hu & Denizkurdu, 2020, p. 216). Their direct engagement in day-to-day business activities positions these professionals to be the first ones to identify practices that are lacking in trustworthiness. By identifying problems early and "keep[ing] problems small, [the first line] contributes materially to the trustworthiness of…the financial system and therefore promotes financial stability" (Held, 2018, para. 7). An example of a problem that first line professionals could identify early—and prevent from becoming a large problem—is a process that lacks clarity around responsibilities. If the individuals responsible for the execution of a process are not clear on where their responsibilities end and the next team member's responsibilities begin, there is a high risk of such a process breaking down. Diligent first line professionals could identify the risk posed by such lack of clarity, drive the establishment of clear responsibilities, and therefore mitigate the risk of a process break-down. In 2018, the Federal Reserve Bank of New York hosted a First Line of Defense Summit, where Michael Held (Executive Vice President of the Legal Group of the Federal Reserve Bank of New York) characterized first line professionals as "not just a first line of defense for [their] organization…[but] the first line of defense against significant risks to the financial system" (para. 7). When first line professionals identify and remediate small problems, they prevent such problems from growing into large ones that could adversely impact the bank's stakeholders and—depending upon the magnitude of the problem—adversely impact the global economy. First line professionals are not on their own as they pursue their mandate to identify and mitigate potentially "significant risks to the financial system" (Held, 2018, para. 7). First line professionals work in partnership with their second line counterparts.

Second Line: Risk Management and Compliance

Second line of defense professionals provide the first line with guidance on ensuring trustworthy business practices, and may identify untrustworthy practices the first line has overlooked. An example of an untrustworthy practice reflecting a diminished level of "competence" would be a process with inadequate controls, which is prone to errors that could adversely impact customers. An example of an untrustworthy practice reflecting a diminished level of "integrity" would be the practice of employees intentionally misleading customers. Cocheo (2014) identifies the second line as being “responsible for checking what is going on in the [first line]” and evaluating the bank’s risk landscape “to get a strong sense of the overall level of risk actually taken, and how it jibes with the risk appetite established by the board” (p. 35). The second line also engages in “setting standards related to…compliance with applicable laws, regulatory requirements, policies, procedures, and standards of ethical conduct” (Hoes & Gehlert, 2020, p. 160). As a bank’s driver of revenue, the first line may be inclined to engage in decision-making that is “skewed towards revenue generation” (Ciocîrlan, 2017, p. 392). The success of many first line professionals is measured by their ability to consistently generate revenue by engaging in activities such as securing relationships with new clients and expanding the scope of services provided to existing clients. Such professionals are often rewarded for successful revenue generation with bonuses, positive performance reviews, and opportunities for career advancement. With such strong incentives to drive revenue, first line professionals may develop tunnel-vision with a focus on revenue generation, while potentially developing a blind-spot for risks associated with these revenue-generating activities. The second line must therefore act as a counterbalance, ensuring that risks inherent to revenue-generating activities are thoroughly evaluated (Ciocîrlan, 2017). While the first line and second line may successfully identify and remediate untrustworthy practices, there is always a possibility that some untrustworthy practices may go unidentified—which is where the third line comes in.

Third Line: Internal Audit

Third line of defense professionals examine practices across the first line and second line to ensure the identification and remediation of untrustworthy practices. The key responsibilities of internal audits are “to ensure that the first two lines are operating effectively and advise how they could be improved” (Bruce, 2017, para. 10). In order to ensure an effective third line of defense, a bank’s board of directors and executive officers must engage in all possible efforts to ensure the third line is “independent and free from any conflict of interest” that may bias their evaluation of the first line and second line (Ciocîrlan, 2017, p. 394). One method for fostering independence in the third line is establishing a reporting structure where third line professionals report to executives that do not have any first line or second line responsibilities. Such a reporting structure provides third line professionals with a chain of command that does not have conflicting interests, or incentives to favor the interests of one line over another. If third line professionals have ties that are too strong to the first line or second line, the third line may become the proverbial fox watching the henhouse. By engaging in an independent review of the first line and second line, the third line serves as the “underpinning of the whole [three lines of defense] framework” (Delgado, 2019, p. 5). Cocheo (2014) compares internal audit professionals to goalies: “[An internal auditor] is the last person to make sure the ball doesn’t go into the net” (Cocheo, 2014, p. 35). If the first line and second line fail to identify and address issues of untrustworthiness, the third line has the final opportunity to handle such issues within the bank. If the third line fails to identify and address issues of untrustworthiness, then the fourth line enters the picture, and significant consequences—such as fines and reputational damage—may follow.

Fourth Line: Regulators and External Auditors

While the Model is comprised of three lines of defense within a bank, “a fourth line of defense may exist by way of external auditors and/or regulators” (Arndorfer & Minto, 2015, p. 9). External auditors and regulators address untrustworthy practices that have gone unidentified and/or unaddressed by the three lines of defense. While the efforts of the fourth line are “building on the work of the other three [lines],” banks “should be designing a [three lines of defense] system which is robust and complete” and not relying on the fourth line to identify their shortcomings (Davies & Zhivitskaya, 2018, p. 39). Adverse regulatory findings may receive widespread media coverage and regulators may impose hundreds of millions—or even billions—of dollars in fines on a bank for engaging in untrustworthy practices (Benoit, 2020; Hagel & Beckerman, 2020). This “pressure” resulting from regulators’ ability to impose “measurable monetary damage as well as reputational damage” provides industry leaders with a strong incentive to ensure their implementation of the Three Lines of Defense Model is highly effective (Hoes & Gehlert, 2020, p. 159).

Global Systemically Important Banks (G-SIBS)

While trustworthiness is vital for all banks, there is a small subset of banks whose trustworthiness—or lack thereof—carries significant global consequences: G-SIBs. The FSB, an “international body that monitors and makes recommendations about the global financial system," defines G-SIBs as "institutions of such size, market importance, and global interconnectedness that their distress or failure would cause…adverse economic consequences across a range of countries" (FSB, 2020, para. 1; FSB, 2010, p. 2). Regulators across the globe hold G-SIBs to heightened standards of trustworthiness, "commensurate with the system-wide expected losses that their failure would produce" (FSB, 2010, p. 2). The FSB published the first list of G-SIBs in 2011 and continues to publish a revised list each November in partnership with banking authorities across the globe, and in partnership with the BCBS, a "global standard setter" for banking regulation with the "purpose of enhancing financial stability" (BCBS, 2018, para. 1; FSB, 2021, p. 1). As of November 2021, 30 banks were designated as G-SIBs by the FSB (FSB, 2021, p. 1). The enduring trustworthiness of G-SIBs is essential to maintaining global economic stability.

Too Big To Fail

When a government must choose between allowing a G-SIB to fail, or intervening to save a G-SIB, intervention is often viewed as the lesser of the evils. G-SIBs are often referred to as "too big to fail" because their failure "threatens to cause such significant disruption to the…economy that these potential costs are judged as too severe to bear, leading to government intervention to prevent the failure" (Dudley, 2013, para. 1). While government intervention may prevent a G-SIB's failure, such intervention yields an unintended consequence: moral hazard. Moral hazard occurs when an individual or entity is willing to engage in high-risk behavior because "they do not bear the full consequences” of such behavior (Kotowitz, 1989, p. 207). In the case of G-SIBs, their failure could be so catastrophic to the global economy that governments will intervene to prevent such failure, providing G-SIBs with an “implicit guarantee at the taxpayers’ expense” (Dudley, 2013, para. 1). Grunwald (2009) states that such implicit guarantees create moral hazard by sending a message that “too big to fail financial firms” will be rescued by governments regardless of how egregious their untrustworthy practices may be (p. 44). By identifying G-SIBs and holding them to heightened standards, the desired outcome is to drive increased accountability and trustworthiness, while minimizing moral hazard. In the next chapter, I explore themes that stand out in the literature on the Three Lines of Defense Model.

CHAPTER 2: AN OVERVIEW OF THE LITERATURE

In the literature on the Three Lines of Defense Model, three prominent themes emerge: (a) culture; (b) costs vs. benefits; and (c) division of responsibilities. A bank's culture will drive the nature of its employees' behavior, impacting the trustworthiness of the bank and ultimately enhancing or diminishing the trustworthiness of the banking industry as a whole (Stiroh, 2018). While investing in the Three Lines of Defense Model may be costly, it is arguably far more costly to fail to invest in fostering trustworthiness. Regulators in the fourth line of defense may fine banks hundreds of millions—or even billions—of dollars for engaging in untrustworthy practices (Benoit, 2020; Hagel & Beckerman, 2020; Kelly, 2020). There is no one-size-fits-all approach to establishing the optimal division of responsibilities across the three lines of defense. A bank's leaders must tailor the Model to align to their bank's unique characteristics, and divide responsibilities across lines accordingly (BCBS, 2011, p. 4).

Culture

Kevin Stiroh (Executive Vice President of the Financial Institution Supervision Group of the Federal Reserve Bank of New York) has spoken at numerous conferences underscoring the importance of organizational culture in driving trustworthiness in the banking industry. As a senior leader in the fourth line of defense, Stiroh derives highly valuable insights on culture from his extensive first-hand experiences. At the 2018 Annual Culture and Conduct Forum for the Financial Services Industry, Stiroh defines a bank's culture as "the shared set of norms that influences decision-making and is evidenced through [employee] behavior" which is ultimately "driven by a multifaceted set of factors including incentives, cues from peers, observations about leaders, and formal policies and procedures" (p. 3). At the 2020 Risk USA Conference, Stiroh leverages the term "cultural capital" to refer to the defining characteristics of a bank's culture, and explores the contrasting behaviors that prevail in banks with low levels of cultural capital and their counterparts with high levels (p. 1). Banks with low levels of cultural capital are characterized by employees' willingness to engage in activities that could adversely impact stakeholders, including illegal activities (Stiroh, 2020, p. 1). In such organizations, "groupthink" is widespread and employees who raise concerns about high-risk behavior are routinely ignored by senior leaders (Stiroh, 2020, p. 1). The effective implementation of the Three Lines of Defense Model is significantly challenging in an environment where trustworthiness is not valued. Due to an inability to effectively implement the Model, untrustworthy and/or illegal activities typically go undetected by all three lines, "only coming to light when discovered by [the fourth line]" (Stiroh, 2020, p. 1). Examples of such untrustworthy and/or illegal activities are explored later in this chapter. Organizations with low levels of cultural capital suffer reputational damage themselves, while also diminishing overall "trustworthiness of the industry over time" (Stiroh, 2020, p. 1). Conversely, organizations with high levels of cultural capital are characterized by employees' unwillingness to engage in excessive risk-taking, and a commitment to behaving lawfully (Stiroh, 2020, p. 1). In such organizations, employees are encouraged to escalate risk-related concerns to senior leaders and are respected for doing so (Stiroh, 2020, p. 1).

Banks with high levels of cultural capital earn reputations as trustworthy institutions and foster overall trustworthiness in the banking industry.

The BCBS (2011) asserts that “a strong risk culture and good communication among the three lines of defense are important characteristics of good operational risk governance” (p. 4). In order to effectively examine how the Three Lines of Defense Model fosters trustworthiness in the banking industry, it is beneficial to further explore the meaning of “risk governance” and identify defining characteristics of distinct “risk cultures.” Risk theorist, Ortwin Renn, defines “risk governance” across industries as “a complex web of actors, rules, conventions, processes, and mechanisms concerned with how relevant risk information is collected, analyzed, and communicated” and ultimately how such information is leveraged by management to make decisions (2008, p. 9). Within the context of the Model, risk governance is the way in which professionals across the three lines identify risk, and the actions they take in response to risk identification. Risk governance may be approached in materially different ways, depending upon an organization’s prevailing risk culture.

Agarwal and Kallapur (2018) explore three distinct risk cultures that frequently emerge across industries: (a) cognitive risk culture; (b) defensive risk culture; and (c) resource-based risk culture. Agarwal and Kallapur (2018) identify the defining characteristic of cognitive risk culture as a focus on “improving the understanding of risk and resolving the problems by addressing their root cause” (p. 330). The objective of defensive risk culture is not necessarily fostering trustworthy behavior, but avoiding the consequences of failing to do so (Agarwal

& Kallapur, 2018). Defensive risk culture often leads to “sub-optimal or even wrong decisions for the sake of preventing lawsuits and blame” (Agarwal & Kallapur, 2018, p. 330). While cognitive risk culture focuses on root cause analysis, and defensive risk culture focuses on blame prevention, resource-based risk culture focuses on fostering resiliency and adaptability in employees. Proponents of resource-based risk culture assert that risks are too numerous to proactively identify and manage, so organizations must “develop the capabilities to adapt successfully” when faced with unanticipated challenges (Agarwal & Kallapur, 2018, p. 330). An organization’s risk culture will drive how employees respond to a wide variety of unanticipated challenges ranging from natural disasters to cybersecurity breaches. Depending upon the prevailing risk culture at a given bank, the way in which the Three Lines of Defense Model fosters trustworthiness will differ significantly: Cognitive risk cultures foster trustworthiness by leveraging root-cause analysis; Defensive risk cultures deflect blame at any cost, with no sincere interest in fostering trustworthiness; Resource-based risk cultures foster trustworthiness by fostering adaptability in employees (Agarwal & Kallapur, 2018).

Cost vs. Benefit

In the opening remarks of the 2019 International Bankers Forum, industry leaders were encouraged to view spending on the Three Lines of Defense Model not as an “additional cost,” but rather as a “long-term investment” (Delgado, 2019, p. 6). While there may be significant costs associated with the successful implementation and ongoing maintenance of the Three Lines of Defense

Model—such as hiring, training, and maintaining high-performing teams across the three lines—there are significant costs associated with failing to do so. In October 2020, the Fed and the OCC fined Citigroup $400 million, due to shortcomings in the bank's systems designed to "identify risk and protect customer data" (Benoit, 2020, para. 8). One month later, the OCC fined JPMorgan Chase $250 million "over deficiencies in internal controls…[and]…deficient risk management practices" (Hagel & Beckerman, 2020, paras. 1-3). While the fines imposed on Citigroup and JPMorgan are significant, they are overshadowed by the $3 billion in fines imposed on Wells Fargo by the U.S. Department of Justice and the Securities Exchange Commission in 2020 for the bank's "fraudulent sales practices" (Kelly, 2020, paras. 1-2). Wells Fargo executives pressured first line professionals to drive revenue by achieving "unrealistic sales goals" (Kelly, 2020, para. 6). To achieve these unattainable goals, thousands of first line professionals "created millions of savings and checking accounts for customers without [the customers'] knowledge or approval" and customers were subsequently charged fees for these fraudulently opened accounts (Egan, 2017, para. 10; Kelly, 2020, para. 3). Wells Fargo also confirmed that thousands of auto loan borrowers "may have defaulted on their car loans or had their vehicles repossessed" due to the bank charging unnecessary insurance costs without borrowers' knowledge or consent (Egan, 2017, para. 2). The consequences for one such borrower, Samir Hanef, illustrate the far-reaching ripple effects of Wells Fargo's untrustworthy practices. When Hanef's car was repossessed because he did not pay the insurance costs—which he was charged without his knowledge or consent—he was unable to commute to his job as a social worker, resulting in his patients failing to receive much-needed services (Egan, 2017). By paying the car repossession fee at his own expense, Hanef was able to get his car back, however his credit score had been so adversely impacted by his bank's actions that he was no longer eligible to refinance his mortgage (Egan, 2017). As a customer, Hanef was directly impacted by his bank's untrustworthy practices, and those who rely on Hanef—namely his patients and his family—were also impacted (Egan, 2017). If Wells Fargo had allocated sufficient resources to the implementation and maintenance of strong risk management practices, perhaps Henef and thousands like him would not have been adversely impacted, and perhaps Wells Fargo would not have been fined $3 billion. Spending on risk management is inevitable, and banking industry leaders must pick their poison: proactively spend on implementing and maintaining strong risk management practices, or reactively spend on paying regulators' fines and remediating broken processes.

Division of Responsibilities

While the general structure of the Model is well-established in the banking industry, there is a "tricky balance to be achieved" when dividing responsibilities between the three lines (Hoes & Gehlert, 2020, p. 159). The OCC acknowledges that excessively rigid implementation of the Model can result in establishing overly formal divisions between responsibilities across lines, rather than taking into account the "the mix of functions performed" within each line (OCC, 2014, p. 54528). During a First Line of Defense Summit hosted by the Federal Reserve

Bank of New York in 2018, Michael Held (Executive Vice President of the Legal Group of the Federal Reserve Bank of New York) addressed the “potential dangers” of implementing the Model too “rigidly” with “excessive formalism” (para. 9). At the summit, Held stressed that the division of responsibilities between the lines should be driven by “independence and expertise” and not by creating barriers between the lines, or unnecessary “silos” (Held, 2018, para. 13). Excessively rigid implementation of the Model can inhibit effective communication between professionals across lines, ultimately diminishing the efficacy of the Model by stifling the kind of collaboration that is essential for identifying and addressing untrustworthy practices.

To maximize the efficacy of the Three Lines of Defense Model, the nuances of the Model’s implementation must be tailored to the unique needs of a given bank. The BCBS (2011) recognizes there is no one-size-fits-all approach to the optimal implementation of the Model and “depending on the bank’s nature, size and complexity, and the risk profile of a bank’s activities, the degree of formality of how these three lines of defense are implemented will vary” (p. 3). If the Model is implemented in a way that is properly aligned to the unique needs of a bank, there should be “no gaps in coverage or unnecessary duplications” and the Model should serve to establish a “clear understanding of unique roles and responsibilities with regard to risk and control” (Hu & Denizkurdu, 2020, p. 215). However, if the Model is implemented in a way that is not well-suited to a bank’s circumstances, it has the “potential to diffuse responsibilities for risk in a way which could reduce accountability rather than enhance it” (Davies & Zhivitskaya, 2018, p. 41). Even if the Model is implemented in an optimal manner for a bank at a specific point in time, the Model's implementation will require ongoing re-evaluations and adjustments. Hu and Denizkurdu (2020) assert that "a large international bank is a live organism with a continuously changing risk profile" (p. 220). A bank's implementation of the Model is not a one-time endeavor: The Model's implementation must continually evolve to align with the bank's ever-changing risk landscape.

Davies and Zhivitskaya (2018) explore the challenge of establishing a desirable proximity between the first line and the second line: not too close, but not too far. Regulators strive "to ensure an appropriate degree of independence for each line" and may view the second line as being too close to the first line to maintain independence—or too far removed from the first line to maintain effective ongoing engagement (Davies & Zhivitskaya, 2018, p. 39). There is no silver bullet for establishing the optimal distance between the first line and the second line, as each bank has its own unique landscape to navigate. Davies and Zhivitskaya (2018) explore two distinct approaches for establishing an optimal relationship between the first line and second line: (a) the partnership model; and (b) the policy and policing model (p. 39). The partnership model is characterized by a very close working relationship between the first line and second line, and sometimes involves "embedding risk professionals in first line teams" (Sweeting, 2017, p. 9). While such close engagement is "harmonious and plausibly effective" it may position the first and second lines a bit too close for regulators' comfort, and make it difficult for a bank to demonstrate that their second line is maintaining the independence necessary to provide “effective challenge” to first line practices (Davies & Zhivitskaya, 2018, p. 39). Second line professionals who are too closely engaged in the first line’s day-to-day activities may not be optimally positioned to engage in objective evaluation of the first line. Their familiarity with the intricacies of first line practices may diminish their ability to see the forest for the trees, and critically analyze first line activities. Reporting lines are also a significant concern: If second line professionals are embedded in the first line, they may report to the same senior leaders as their first line counterparts. Within such a reporting structure, second line professionals are subordinate to the senior leaders whose practices they must objectively evaluate. Without a chain of command that is fully independent from the first line, second line professionals may find themselves unable to effectively escalate concerns regarding first line practices. The policy and policing model is characterized by placing a significant amount of distance between the first and second lines, with the second line “setting risk management policies and then monitoring the extent to which those policies are complied with” (Sweeting, 2017, p.9). Establishing the second line as an “oversight function” for the first line rather than a partner has its pros and cons: While the second line has a high degree of independence from the first line, the second line no longer has active engagement in the day-to-day activities of the first line, and the opportunities for dialogue that come with such close proximity (Davies & Zhivitskaya, 2018, p. 39). The next chapter details my process of designing and conducting a confidential online survey.

CHAPTER 3: METHODOLOGY

I designed and conducted a confidential online survey to gather insights from professionals with first-hand experience in the Three Lines of Defense Model within the banking industry. In this chapter, I provide an overview of the criteria for survey participation, my approach to recruiting survey respondents, and my process of piloting the survey. I also detail the structure of the survey, which includes Likert-type scale questions, multiple-choice questions, and open-ended questions.

Criteria for Participation and Recruitment

To be eligible for participation in the survey, respondents were required to have experience in any role in the Three Lines of Defense Model within the banking industry, including the fourth line of defense (i.e., regulators and external auditors). Respondents could have experience at G-SIBs and/or non-G-SIBS, as the survey is focused on the efficacy of the Model within the banking industry, and not exclusively focused on a specific type of bank. I built the online survey in the Qualtrics platform and collected responses between January 2021 and March 2021. I primarily recruited respondents on LinkedIn using snowball sampling, a recruitment method that leverages “interpersonal relations” to conduct research (Browne, 2005, p. 47). I chose to leverage LinkedIn as my primary platform for recruitment, as LinkedIn is the most effective avenue for accessing my professional social network. My posts on LinkedIn featured a recruitment flyer and a recruitment script, which are reflected in the Appendix. In addition to

LinkedIn, I recruited respondents through the University of Pennsylvania's Organizational Dynamics Listserv.

While snowball sampling enabled me to successfully recruit survey respondents with the requisite professional background, there are drawbacks to this sampling method. One drawback is that respondents often recruit other respondents "who share similar characteristics, or the same outlook" (Etikan, et al., 2015, p. 1). In this way, snowball sampling does not lend itself to achieving a perfectly balanced pool of respondents. It would have been desirable for this survey to reflect feedback from an equal number of respondents from each line of defense, as well as an equal number of respondents from G-SIBs and non-G-SIBs, however the population of survey respondents closely resembles the population of my professional network: predominantly first line and second line professionals within G-SIBs.

Survey Design

Before beginning respondent recruitment, I conducted a pilot survey with two banking professionals: one professional had experience across all three lines of defense, and one professional had experience exclusively in the first line. Both pilot participants are part of my professional network, and I selected them to take part in the pilot to provide me with their unique perspectives. Conducting a pilot for research instruments, such as surveys or interviews, can serve as a valuable method for "developing and testing the adequacy of research instruments" before launching a study (van Teijlingen & Hundley, 2002, p. 34). The "validity" of a survey is enhanced by gathering and acting upon feedback from pilot participants on a range of topics such as identifying “difficult or ambiguous questions” that may require “re-word[ing]” to elicit the desired feedback from respondents (van Teijlingen & Hundley, 2002, p. 35). Conducting a pilot may also serve as an effective method for identifying and eliminating leading language. Researchers may consciously or subconsciously hold a strong attachment to a specific survey outcome and unintentionally design a research instrument with leading language “that is sure to “confirm [their] desired result” (Kitchenham & Pfleeger, 2002, p. 20). Based on feedback I received from the pilot participants, I refined the survey’s language to enhance the specificity and clarity of certain questions. One Likert-type scale question was significantly enhanced by my incorporation of pilot participant feedback: “Senior leaders in the banking industry demonstrate a meaningful understanding of the Model.” My first draft of this question referred to “organizations” demonstrating a meaningful understanding, rather than “senior leaders.” My pilot participants helped me refine this question to specify whose understanding of the Model I wanted respondents to evaluate.

My research protocols, including the survey, were approved by the Institutional Review Board (IRB) at the University of Pennsylvania with “exempt” status. The University of Pennsylvania IRB is a federally regulated entity, which reviews biomedical and social behavioral research proposals in order to “determine if the proposed research meets certain…criteria to protect the rights and welfare of the human subjects” (University of Pennsylvania, n.d., para. 1). “Exempt” status is granted to studies posing “minimal risks” to participants, such as accidental disclosure of private information (Federal Register, 2017, p. 7260).

In a study with “exempt” status, “the probability and magnitude of harm or discomfort anticipated in the research are not greater in and of themselves than those ordinarily encountered in daily life or during the performance of routine physical or psychological examinations or tests” (Federal Register, 2017, p. 7260).

While the survey did not ask respondents to disclose any personally identifying information—such as name, employer, or age—the survey’s open-ended questions provided respondents with the opportunity to share feedback in free-form text fields. Any information gathered through open-ended questions that could potentially be personally identifying in nature is not disclosed in my research findings. Confidentiality was essential to ensuring respondents could safely provide candid feedback on their experiences working within the Model. If a respondent were to share feedback on a certain bank’s implementation of the Model, and that feedback were to be disclosed in a personally identifying manner, such disclosure could cause reputational damage to the respondent, the bank, and myself as a researcher and banking industry professional.

Survey Structure

The 36-question survey takes approximately 20 minutes for a respondent to complete and is constructed of Likert-type scale questions, multiple-choice questions, and open-ended questions. A detailed overview of the survey is reflected in Table 1 and the full survey is reflected in the Appendix. The survey was designed to gather information regarding the respondents’ professional background and their insights on the efficacy of the Three Lines of Defense

Model. Insights on the Model's efficacy were gathered in the form of qualitative data (via open-ended questions) and quantitative data (via multiple-choice and Likert-type scale questions). By collecting both qualitative and quantitative data, researchers are positioned to leverage "the qualitative research to inform the quantitative portion of research studies, and vice versa" (Onwuegbuzie & Leech, 2007, p. 383). Onwuegbuzie and Leech (2007) characterize researchers who use both qualitative and quantitative methods as being "armed with a bifocal lens…rather than a single lens" (p. 383). In this study, the qualitative data provided me with valuable insights and context that informed my ability to meaningfully interpret the quantitative data—and vice versa.

The survey includes seven Likert-type scale questions, each of which presents the respondent with a statement regarding the Model's efficacy and provides six possible responses ranging from "Strongly Agree" to "Strongly Disagree." Likert-type scales provide survey respondents with a "range of responses to a statement or series of statements" and are "useful in social science and attitude research projects" (Croasmun & Ostrom, 2011, p. 19). In this study, responses to the Likert-type scale questions provide a framework for quantifiably measuring respondents' sentiments regarding the efficacy of the Model.

The survey includes 13 open-ended questions regarding the Model's efficacy, seven of which are directly tied to a Likert-type scale question and ask the respondent to provide details on the first-hand experiences that informed their response to the corresponding Likert-type scale question. Open-ended questions bring both significant advantages and significant challenges to the research process. One of the greatest advantages of open-ended survey questions is “discover[ing] the responses that individuals give spontaneously” while “avoid[ing] the bias that may result from suggesting responses” (Reja et al., 2003, p. 159). A significant challenge presented when conducting analysis on open-ended survey answers is reviewing a large population of free-form responses and “determining what is worth analyzing” (Vaughn & Turner, 2015, p. 50). Vaughn and Turner (2015) recommend that researchers can bring “focus to the process of analyzing qualitative data” by “coding along themes and topics to highlight priorities” (p. 50). I leveraged open codes and in vivo codes in the process of analyzing respondents’ answers to open-ended survey questions. Open codes are terms or short phrases established by the researcher to “describe conceptually what the researcher believes is indicated by the data” (Corbin & Strauss, 2008, p. 160). In vivo codes are not created by the researcher, but are rather “the actual words of research participants” (Corbin & Strauss, 2008, p. 65). I also engaged in axial coding, which is the process of “relating minor concepts to broader level concepts” within research findings (Corbin & Strauss, 2008, p. 193).

In response to the survey’s open-ended questions, respondents shared detailed accounts of first-hand experiences that have shaped their views on the Model’s efficacy. The content of these open-ended answers provided valuable insights to my research, which would not have been gathered if I had constructed the survey exclusively of multiple-choice and Likert-type scale questions. Survey respondents shared particularly valuable feedback on open-ended questions regarding the Model's greatest strength and greatest weakness. One respondent identified the Model's greatest strength as "holding people accountable" while "providing oversight [and] challenge." When providing feedback on the Model's greatest weakness the same respondent emphasized that ultimately, the Model "is only as good as its people" across the three lines. Such insights would not have been gathered if the survey had been constructed exclusively of multiple-choice and Likert-type scale questions. The recruitment flyer, recruitment script, and full survey are reflected in the Appendix.

The survey questions focus on two topics: (a) professional background of the respondent; and (b) efficacy of the Three Lines of Defense Model, based on the respondents' first-hand experience. The survey questions are structured in three ways: (a) multiple choice; (b) open-ended; and (c) Likert-type scale. Table 1 provides an overview of how I leveraged these two topics and three question structures to construct the 36-question survey.

Table 1

Survey Questions

Topic	Question Type	Description	Count
Professional Background	Multiple Choice	Respondents shared details about their professional experience within the Model, such as which lines they have worked in.	14
	Open-Ended		2
Efficacy of the Three Lines of Defense Model	Likert-Type Scale	Respondents selected a response on a 6-point Likert-type scale to statements regarding the Model's efficacy: (a) Strongly Agree; (b) Agree; (c) Somewhat Agree; (d) Somewhat Disagree; (e) Disagree; and (f) Strongly Disagree.	7
	Open-Ended (Follow-Up to Likert-Type Scale Questions)	Respondents provided details on the first-hand experiences that informed their response to the corresponding Likert-type scale question.	7
	Open-Ended (Unrelated to Likert-Type Scale Questions)	Respondents provided feedback on topics such as the Model's greatest strength and greatest weakness.	6
		Total	36

Bracketing

While analyzing qualitative survey data, I engaged in bracketing to ensure my first-hand experiences within the Three Lines of Defense Model would not influence my data interpretation. Tufford and Newman (2010) define bracketing as “a method used in qualitative research to mitigate the potentially deleterious effects of preconceptions that may taint the research process” (p. 50). Bracketing requires a researcher to consciously identify their “vested interests, personal experiences, cultural factors, assumptions, or hunches” that could impact their interpretation of research data (Fischer, 2009, p. 583). Moreover, bracketing is an “ongoing practice” of “self-consciously and regularly check[ing] to see whether one is imposing meanings on the data” (Fischer, 2009, p. 584). As I analyzed open-ended feedback from respondents, I engaged in bracketing by leveraging coding to quantify how frequently a certain theme was addressed by respondents. This quantification provided me with a method for objectively evaluating the prevalence of themes, rather than allowing myself to be drawn to themes that mirror my experiences and reflect my beliefs.

CHAPTER 4: DATA ANALYSIS AND FINDINGS

In this chapter, I provide an overview of key findings that emerged from the survey's qualitative and quantitative data. Of the 58 respondents who participated in the survey, I have included data from 43 respondents in my analysis. I excluded 15 respondents for two key reasons: (a) They indicated they did not have experience in the Three Lines of Defense Model within the banking industry, or (b) They did not answer any questions regarding the Three Lines of Defense Model's efficacy—therefore providing no insights on the Model. Respondents provided answers to questions regarding the Model in three parts: (a) Seven six-point Likert-type scale questions, with answers ranging from "Strongly Agree" to "Strongly Disagree;" (b) Seven open-ended questions asking respondents to share their first-hand experiences that informed their Likert-type scale answers; and (c) Six open-ended questions asking for respondents feedback on topics such as the Model's greatest strength and greatest weakness. A detailed overview of the survey is reflected in Table 1 and the full survey is reflected in the Appendix.

Respondents' Background: Three Lines of Defense

Across the 43 respondents included in my analysis, experience was reported across all three lines of defense, as well as the fourth line. As reflected in Table 2, first line experience was most prevalent among respondents, with 37 respondents (86%) reporting experience in the first line. Twenty-three respondents (53%) reported experience in second line compliance, while fifteen (35%) reported experience in second line risk. Thirteen respondents (30%)

reported experience in the third line. Fewer respondents reported experience in the fourth line of defense with seven (16%) reporting experience in external audit and three (7%) reporting experience working for a banking regulator. Twenty-six respondents (60%) reported experience in more than one line, while 17 (40%) reported experience exclusively in one line.

Table 2

Survey Respondents

Line of Defense	Role	Experience	Unanswered	Total
First Line of Defense	Business Management	37	6	43
		86%	14%	100%
Second Line of Defense	Compliance	23	20	43
		53%	47%	100%
	Risk	15	28	43
		35%	65%	100%
Third Line of Defense	Internal Audit	13	30	43
		30%	70%	100%
Fourth Line of Defense	External Audit	7	36	43
		16%	84%	100%
	Regulator	3	40	43
		7%	93%	100%

Respondents' Background: Banks

Across the 43 respondents included in my analysis, 36 respondents (84%) reported they were employed by a bank at the time they participated in the survey: Thirty-five respondents (81%) reported they were employed by a G-SIB; one respondent (2%) reported they were employed by a non-G-SIB; seven respondents (16%) did not specify the nature of their current employer.

Respondents indicated if they had previously been employed by G-SIBs and/or by non-G-SIBs. In evaluating the answers to questions regarding previous employers, I concluded there had been a disconnect between the intended questions, and the answers provided by respondents. Thirty-five respondents indicated they were employed by a G-SIB at the time of the survey. Of those 35 respondents, 22 reported they'd also had a G-SIB as a previous employer—indicating they'd been employed by at least two G-SIBs. Of the 22 respondents who indicated they'd been employed by at least two G-SIBs, only 12 reported they'd been employed by more than one bank that had implemented the Model—indicating that 10 respondents had been employed by G-SIBs that had not implemented the Model. It is a banking industry standard for all G-SIBs to implement the Model, so due to the nature of these responses, I concluded the questions had not been understood as intended. I believe respondents misunderstood the survey questions regarding previous employers because these questions lacked clarity. While I received highly valuable feedback from the two participants in my survey pilot, I may have benefited from engaging a larger number of participants. Van Teijlingen and Hundley (2002) underscore the value of gathering feedback from pilot participants regarding “difficult or ambiguous questions” that may require “re-word[ing]” (p. 35). Additional participants may have identified the lack of clarity in the survey questions regarding previous employers. I have omitted any quantitative analysis based on answers to questions regarding previous employers, however I have included qualitative free-form answers respondents provided comparing their experiences across different employers.

Respondents shared their observations on key differences in the implementation of the Three Lines of Defense Model across different banks where they had been employed. Respondents who had professional experience exclusively at G-SIBs indicated the implementation of the Model was “relatively consistent” across the G-SIBs. Respondents who had experience at both G-SIBs and non-G-SIBs reported more significant differences in the Model’s implementation. One respondent who had been employed by a non-G-SIB, indicated that the bank’s CEO “was not interested in the Three Lines of Defense Model” due to being “extremely expense conscious” and “not interested in spending money on such things.” Another respondent indicated that G-SIBs require more “considerable levels of coordination, communication, and alignment of resources” compared to their non-G-SIB counterparts. This respondent went on to highlight that G-SIBs must navigate a complex international landscape, as they are supervised by “multiple regulatory bodies across the globe,” while many non-G-SIBs are supervised by regulators in one country. A respondent who was employed by a G-SIB at the time of completing the survey, expressed that a key driver of G-SIBs' rigorous implementation of the Model is their leaders' heightened "sense of accountability" because of the far-reaching global impact of G-SIBs' actions. This respondent's feedback aligns with sentiments expressed by the FSB. The FSB defines G-SIBs as "institutions of such size, market importance, and global interconnectedness that their distress or failure would cause…adverse economic consequences across a range of countries" (FSB, 2010, p. 2). Due to G-SIBs' "global interconnectedness," regulators worldwide hold G-SIBs to heightened standards "commensurate with the system-wide expected losses that their failure would produce" (FSB, 2010, p. 2). The next section explores respondents' insights on the Model's role in driving trustworthy behavior and efficiency in the banking industry.

Trustworthiness: Ethical Behavior and Efficiency

Respondents provided their feedback on the following statement: "Overall, the Model contributes to making the banking industry more trustworthy in terms of ethical behavior (e.g., a culture with high ethical standards is established and unethical behavior is minimized due to the Model)." Seventy-two percent of respondents indicated they either "Strongly Agreed" (21%) or "Agreed" (51%) with the statement. Additional details are reflected in Figure 1. Two key themes that emerged in respondents' feedback on this statement were the importance of "culture" and the importance of "checks and balances." One respondent who "Strongly Agreed," indicated that "ethical behavior is an element of culture, [and] culture is driven by management/leadership." This respondent's feedback is reminiscent of a quote attributed to the "founder of modern management," Peter

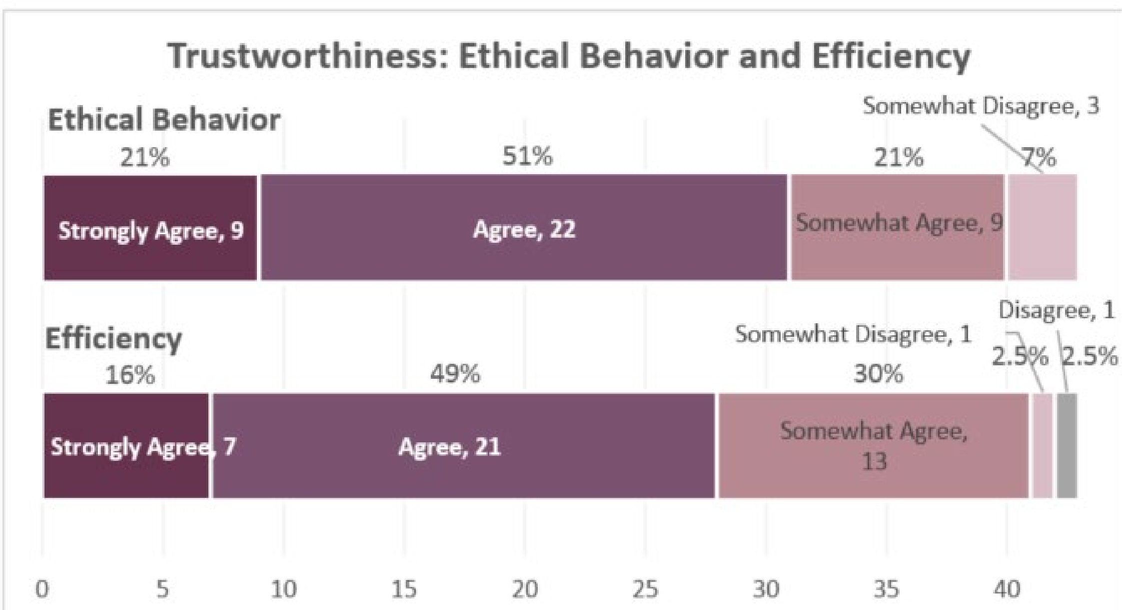
Drucker: “Culture eats strategy for breakfast” (Denning, S., 2014, para. 1; Engel, J., 2018, para. 1). The survey respondent and Drucker both contend that organizational culture will ultimately drive employee behavior. If an organization’s culture is aligned to valuing trustworthiness, then the Three Lines of Defense Model can serve as an effective framework for fostering trustworthiness. If an organization’s culture does not value trustworthiness, implementation of the Model—without a change in culture—will not foster trustworthiness. If an organization’s culture is at odds with an organization’s strategy, there is no contest: Culture will “eat” strategy every time (Engel, J., 2018, para. 1). Respondents also underscored the importance of checks and balances, with one respondent who “Agreed” stating that “having one line check on the other [line] creates [the] opportunity to mitigate risk.” Another respondent who “Strongly Agreed” stated that the “independence of the three lines…creates appropriate checks and balances.” One respondent who “Somewhat Disagreed” indicated that a lack of independence between the lines can undermine the intended efficacy of checks and balances.

Respondents then shared their perspective on the following statement: “Overall, the Model contributes to making the banking industry more trustworthy in terms of functioning more efficiently (e.g., more effective controls are in place and mistakes are minimized due to the Model).” Sixty-five percent of respondents indicated they either “Strongly Agreed” (16%) or “Agreed” (49%) with the statement. Additional details are reflected in Figure 1. Once again, the themes of “culture” and the importance of “checks and balances” emerged in respondents’ comments. One respondent who “Agreed” underscored the importance of culture, stating that the Three Lines of Defense Model is not a “silver bullet” and cannot be expected to be effective “without strong and ethical leadership.” Two respondents who “Agreed” highlighted the importance of ensuring appropriate checks and balances, especially on first line activities, with one respondent underscoring the necessity for the other lines to check the “decision-making” of first line employees who are responsible for “driving new or incremental business.” Ciocîrlan (2017) asserts that first line employees, who are accountable for driving revenue, may be inclined to engage in decision-making that is focused solely on revenue generation, without fully considering the broader risk landscape (p. 392). Ciocîrlan (2017) underscores the importance of ensuring second line professionals engage in a thorough evaluation of risks associated with first line revenue-generating activities.

One respondent who “Disagreed” also focused on the importance of engaging in checks on the first line. However, this respondent expressed concerns that the Model lends itself to allowing the second line and third line to assume no accountability for managing first line risk, acting as a detached “advisors,” rather than acting as true “partners” who learn the “intricacies” of the first line and share accountability for first line risk management. This respondent observed a Model in which the intended checks and balances became an exercise in simply “shifting” accountably for risk management fully to the first line, rather than all three lines working together with shared accountability to manage the risk. This respondent describes dynamics between the lines which Davies and Zhivitskaya (2018) refer to as the “policy and policing model,” in which the other lines act as “oversight function[s]” for the first line, rather than acting as partners (p. 39). This respondent’s feedback reflects a strong preference for the “partnership model,” which is characterized by highly collaborative relationships across the lines (Sweeting, 2017, p. 9). The “policy and policing model” and the “partnership model” each have their own merits, which are explored in Chapter 2. The next section explores respondents’ insights on interactions across the three lines, with a focus on challenge, communication, and roles.

Figure 1

Trustworthiness: Ethical Behavior and Efficiency



Interactions Across Lines: Challenge, Communication, and Roles

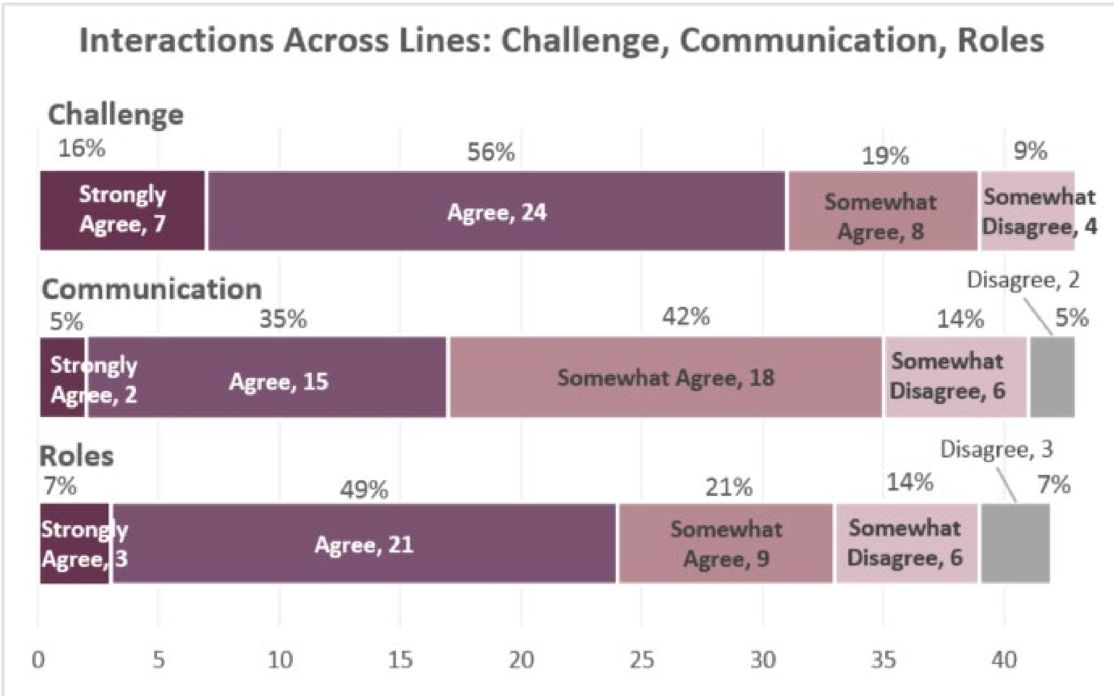
Respondents provided their feedback on the following statement: “Professionals across the three lines constructively challenge each other, identifying and pursuing opportunities to strengthen practices within the banking industry." Seventy-two percent of respondents either "Strongly Agreed" (16%) or "Agreed" (56%) with the statement. Additional details are reflected in Figure 2. Respondents underscored the importance of ensuring the three lines remain "independent" of each other to foster "healthy debate" and to encourage a heightened level of "diligence" in anticipation of being challenged. Two respondents who "Somewhat Agreed" felt that lack of collaboration between the lines hindered meaningful challenge, while one respondent who "Somewhat Disagreed" cited a lack of understanding about responsibilities across lines and the structure of the Model itself, precluding meaningful challenge.

Respondents then shared their perspectives on the following statement: "Clear and meaningful communication consistently takes place between the three lines." Forty percent of respondents either "Strongly Agreed" (5%) or "Agreed" (35%) with the statement, while 42% "Somewhat Agreed." The remaining 19% "Somewhat Disagreed" (14%) or "Disagreed" (5%). Additional details are reflected in Figure 2. A key theme that emerged across respondents' feedback was summarized well by one respondent who "Disagreed," stating that the quality of communication between the lines "has more to do with the people in the roles, rather than the Model itself." One respondent who "Somewhat Agreed" stated the nature of communication across lines "depends upon the people involved and how good they are at their job." Two additional respondents echoed these sentiments and underscored the essential role management plays in facilitating meaningful communication between the lines. One respondent who "Agreed" indicated that the quality of communication was "highly dependent upon the management process" for appointing qualified professionals to key roles across the lines, while another respondent who "Somewhat Agreed" attributed the quality of communication to the "management styles of those in lead positions." A respondent who "Somewhat Disagreed" stated that it was necessary for executives to "lead by example to reinforce the need to communicate appropriately." Kevin Stiroh (Executive Vice President of the Financial Institution Supervision Group of the Federal Reserve Bank of New York) has spoken at numerous conferences underscoring the importance of organizational culture in driving trustworthiness in the banking industry—and underscoring the essential role that industry leaders play in fostering a trustworthy culture. Stiroh's work on culture is explored in Chapter 2.

Respondents then provided their feedback on the following statement: "The division of responsibilities between the three lines is clear, and professionals demonstrate a commitment to fulfilling those responsibilities (i.e., Professionals across all three lines fulfill their responsibilities, so one line does not need to overcompensate for another line's lack of commitment to the Model)." Fifty-six percent of respondents either "Strongly Agreed" (7%) or "Agreed" (49%) with the statement. Twenty-one percent "Somewhat Agreed," while 14% "Somewhat Disagreed," and 7% "Disagreed". One key theme that emerged in respondents' feedback was that first line professionals were inclined to rely too heavily on their second line counterparts. Respondents reflected varying perceptions on how this dynamic develops between the first line and second line. A respondent who "Agreed" expressed concerns that first line professionals sometimes feel that an issue is “no longer [their] problem” once they’ve engaged the second line. A respondent who “Somewhat Disagreed” felt the first line was often “over-reliant” on the second line, however this respondent believed both the first line and the second line shared responsibility for this “over-reliant” dynamic: The second line “allowed that relationship” to develop with the first line so a “change in culture” would lead to the “appropriate alignment of responsibilities.” Another respondent who “Agreed” expressed concerns about adequate first line engagement, however this respondent felt that lack of first line engagement was “not motivated by a lack of commitment to upholding responsibilities” but a lack of understanding that could ultimately be “alleviated by training and conversation” leading to effective collaboration across lines. One respondent who “Somewhat Agreed” expressed that “as long as [professionals across lines] stay within their lanes, collaborate, cooperate, understand and respect each other’s roles/functions, the Model can be very effective.” Davies and Zhivitskaya (2018) explore the challenge of establishing the optimal relationship between the first line and second line, evaluating approaches such as the “partnership model” and the “policy and policing model” (p. 39). Davies and Zhivitskaya’s research findings are summarized in Chapter 2. The next section explores respondents’ insights on industry leaders’ understanding of and commitment to the Model.

Figure 2

Interactions Across Lines: Challenge, Communication, Roles



Leaders: Understanding and Commitment

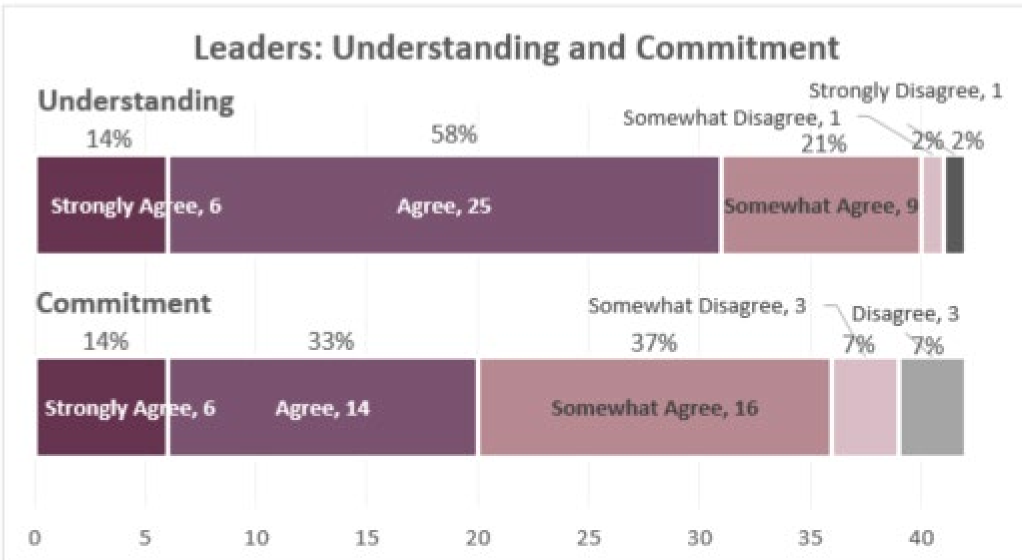
Respondents provided their feedback on the following statement: “Senior leaders in the banking industry demonstrate a meaningful understanding of the Model.” Seventy-two percent of respondents either "Strongly Agreed” (14%) or “Agreed” (58%) with the statement. Additional details are reflected in Figure 3. One respondent who “Strongly Agreed” indicated that the Model had become an industry standard, and leaders had “a very solid understanding of the Model and its benefits.” Another respondent who “Agreed” echoed sentiments about the Model being an industry standard, stating that the Model is “embedded enough now in the industry” that leaders understand it. One respondent who “Strongly Disagreed” indicated that while senior leaders may have a high-level, theoretical appreciation of the Model's importance, they do not truly understand how the Model works.

Respondents then shared their perspectives on the following statement: "Senior leaders in the banking industry demonstrate a commitment to the successful implementation of the Model by dedicating appropriate human resources, funding, and employee training to support the Model." While 72% of respondents "Strongly Agreed" or "Agreed" that senior leaders understood the Model, this number dropped to 47% of respondents "Strongly Agreeing" (14%) or "Agreeing" (33%) that these same leaders demonstrated a commitment to the successful implementation of the Model. Why would industry leaders with a meaningful understanding of the Model's importance not demonstrate commitment to the successful implementation of the Model? One key theme emerged: funding. A respondent who "Somewhat Agreed" stated that funding is "always a challenge" and a respondent who "Disagreed" indicated that "resourcing is never adequate." Respondents indicated that one key force does have the power to drive leaders to allocate increased funding to the Model: regulatory pressure. Regulators may impose hundreds of millions—or even billions—of dollars in fines on a bank for engaging in untrustworthy practices (Benoit, 2020; Hagel & Beckerman, 2020). Industry leaders have a strong incentive to allocate significant funding to the Three Lines of Defense Model in order to mitigate the risk of their banks being subject to considerable "monetary damage as well as reputational damage" resulting from adverse regulatory findings (Hoes & Gehlert, 2020, p. 159). One respondent who "Somewhat

Agreed" stated that decisions regarding "resources and funding [for the Model] are driven by regulator expectations," and another respondent who "Somewhat Agreed" indicated that funding for the Model is a direct result of "regulatory scrutiny." The next section explores respondents' insights on the Model's greatest strength.

Figure 3

Leaders: Understanding and Commitment



Greatest Strength

When respondents were asked to identify the greatest strength of the Three Lines of Defense Model, the key theme that emerged was the Model's ability to simultaneously foster "collaboration" between the lines, while maintaining each line's "independence." Respondents indicated that "independence" between the lines is essential for fostering a culture that values "checks and balances," "challenge of ideas," and "accountability." One respondent stated that establishing such a culture “raises the bar for risk identification and mitigation” which ultimately fosters trustworthiness.

When asked how the Model’s greatest strength could be fostered, respondents indicated that banking industry leaders must:

- allocate adequate funding for hiring, to ensure appropriate resources are dedicated to each line;
- allocate adequate funding for professionals to engage in ongoing training on the Model;
- provide clear guidance on how roles and responsibilities are to be divided across the lines; and
- engage in ongoing communication with professionals highlighting the leaders’ dedication to the Model.

One respondent underscored the importance of leaders maintaining a “strong tone from the top” and “holding all three lines in equal regard.” This respondent echoed the sentiments of Kevin Stiroh (2020) who emphasizes that is the “responsibility [of industry leaders] to set the tone from the top” by “modeling desired behaviors” (para. 11.) If leaders aspire to foster trustworthiness in their organizations, they must begin by consistently demonstrating their own trustworthiness. The next section explores respondents’ insights on the Model’s greatest weakness.

Greatest Weakness

When respondents were asked to identify the greatest weakness of the Three Lines of Defense Model and provide recommendations on how the weakness could be mitigated, respondents focused on four key areas:

Professionals. The Model is “only as good as its people” so it’s essential for leaders engaged in the hiring process to make thoughtful “selections of individuals to fill roles [across the three lines of defense].”

Understanding the Model. Professionals may have “gaps in practical understanding” of the Model, which could be addressed by leaders investing in “additional training.”

Lack of Collaboration. Professionals may experience a lack of collaboration characterized by “poor communication between lines.” Leaders could address this lack of collaboration by fostering a “culture that promotes partnership” and the “spirit of cooperation.” It is not adequate for leaders to simply say they promote “partnership” and “cooperation” across lines; such values must be at the “core of the corporate culture, such that leaders breathe it and live it by example.”

Roles and Responsibilities. Professionals across lines may experience challenges driven by how “roles and responsibilities” are defined by their bank’s leaders. A key theme that emerged in respondents’ feedback regarding roles was the importance of leaders defining roles in such a way that was not excessively “rigid,” while also not going too far in the other direction and defining roles in a way that was exceedingly “unclear.”

Respondents expressed that if leaders define roles in an excessively "rigid" manner, this may lead to "siloing" and a potential "us-versus-them mentality" developing between the lines. On the other hand, respondents expressed that if leaders define roles in an "unclear" manner, this may lead to an "overlap of activities," ultimately fostering "contentious" relationships between the lines. Concerns expressed by respondents about the complexity of establishing "roles and responsibilities" across the lines are echoed throughout the literature. Held (2018) strongly advises against implementing the Model too "rigidly" which can result in barriers, or "silos," developing between the lines (paras. 9-13). Hu and Denizkurdu (2020) emphasize the importance of leaders clearly establishing "unique roles and responsibilities" across the lines in order to avoid "unnecessary duplications" of work (p. 215). The next section explores respondents' closing feedback regarding the Model.

Closing Feedback

The final survey question invited respondents to provide any additional feedback they'd like to share about their experiences working within the Three Lines of Defense Model. The key message that emerged is that the Three Lines of Defense Model serves as a highly effective framework for driving trustworthiness in the banking industry—however, the Model's efficacy is squarely dependent on the professionals implementing the Model. As one respondent commented, "The three lines of defense are made up of people [and] a chain is as strong as its weakest link." Another respondent indicated that the

Three Lines of Defense Model is “a strong model” but only “when it is properly administered, resourced, and managed.” These sentiments were echoed by a respondent who characterized the Model’s efficacy as being “highly dependent on individuals in the roles, but equally important is the mutual respect for each role and a collaborative work environment.” The respondent goes on to warn that “without collaboration and respect for different perspectives” between professionals across lines, the “integrity” of the Three Lines of Defense Model is “in jeopardy.”

CHAPTER 5: CONCLUSION

In the process of conducting this research, insights have emerged from the literature and survey responses that have provided me with enhanced clarity on the meaning of trustworthiness, the importance of trustworthiness, and the role the Three Lines of Defense Model plays in fostering trustworthiness in the banking industry. While the survey yields valuable insights, I view the unbalanced pool of respondents as its key limitation. Due to the use of snowball sampling, the population of survey respondents closely resembles the population of my professional network: predominantly first line and second line professionals within G-SIBs. In future research, meaningful insights could be gained by gathering survey feedback from an equal number of respondents from each line of defense, as well as an equal number of respondents from G-SIBs and non-G-SIBs. Findings from such a survey would facilitate the comparison of perspectives across lines, and across G-SIBs and non-G-SIBs. In this final chapter, I summarize key takeaways from my research.

What is Trustworthiness?

Trustworthiness is comprised of two essential characteristics: integrity and competence (Dia, 2011). “Integrity” is defined by the Cambridge Dictionary as “the quality of being honest and having strong moral principles that you refuse to change.” “Competence” is defined by the Cambridge Dictionary as the “ability to do something well.” It’s not adequate for bank employees to behave with integrity; employees must also possess the competence to protect customers from harm, such as loss of assets entrusted to the bank. Three lines of defense professionals must challenge each other and challenge their bank's established practices as a method for identifying opportunities to consistently foster both integrity and competence.

Why is Trustworthiness Important?

When examining the importance of trustworthiness in banking, three key perspectives emerged in my research: (a) global perspective; (b) bank-specific perspective; and (c) individual perspective. The global perspective of trustworthiness focuses on the role G-SIBs play in the banking industry. While trustworthiness is vital for all banks, there is a small subset of banks whose trustworthiness—or lack thereof—carries significant global consequences: G-SIBs. G-SIBs are "institutions of such size, market importance, and global interconnectedness that their distress or failure would cause…adverse economic consequences across a range of countries" (FSB, 2020, para. 1; FSB, 2010, p. 2). The enduring trustworthiness of G-SIBs is essential for maintaining global economic stability. The bank-specific perspective of trustworthiness focuses on the ways in which trustworthy practices are essential for the success of a given bank. Regulators may impose hundreds of millions—or even billions—of dollars in fines on a bank for engaging in untrustworthy practices (Benoit, 2020; Hagel & Beckerman, 2020). Industry leaders have a strong incentive to foster trustworthiness in their respective banks, in order to mitigate the risk of their banks being subject to considerable "monetary damage as well as reputational damage" due to adverse regulatory findings (Hoes & Gehlert, 2020, p. 159). The individual perspective of trustworthiness focuses on the ways in which individuals are directly impacted by their bank's trustworthiness. Due to untrustworthy practices at Wells Fargo, many customers—and individuals who rely on those customers—were adversely impacted. Samir Hanef was one such customer whose car was repossessed due to Wells Fargo's untrustworthy practices and consequently, he was unable to commute to his job as a social worker, resulting in his patients failing to receive much-needed services (Egan, 2017). Hanef's credit score had been so damaged by the repossession of his car, that he was no longer eligible to refinance his mortgage (Egan, 2017). As a customer, Hanef was directly impacted by his bank's untrustworthy behavior, and individuals who rely on Hanef—namely his patients and his family—were also personally impacted (Egan, 2017). The global perspective, bank-specific perspective, and individual perspective converge on the conclusion that trustworthiness is an absolutely essential component of a thriving banking industry and a thriving global economy.

Does the Three Lines of Defense Model Foster Trustworthiness?

While the Three Lines of Defense Model serves as an effective framework for fostering trustworthiness in the banking industry, the Model is certainly no silver bullet. When examining key factors that drive the efficacy of the Model, two key themes emerged in my research: (a) implementation; and (b) culture. There is no one-size-fits-all approach to the optimal implementation of the Model, and leaders must carefully evaluate a bank's "nature, size…complexity…[and] risk profile" in order to determine how the Model can best be implemented to align to a bank's unique characteristics (BCBS, 2011, p. 3). While the general structure of the Model is well-established within the industry, there is a “tricky balance to be achieved” when dividing responsibilities between the three lines (Hoes & Gehlert, 2020, p. 159). Excessively rigid implementation of the Model can inhibit effective communication between professionals across lines, while excessively vague implementation of the Model can result in confusion regarding the division of responsibilities across lines. Even if the Model is successfully implemented in a way that is ideal for a bank at a given point in time, the Model’s implementation will require ongoing re-evaluations and adjustments, as the bank’s risk landscape evolves (Hu & Denizkurdu, 2020, p. 220).

The Model’s efficacy is dependent on the prevailing culture of a bank. Employees’ “observations about leaders” act as a key force in shaping an organization’s culture, which is why it is essential for leaders to demonstrate their commitment to operating in a trustworthy manner (Stiroh, 2018, p. 3). Banks with cultures that do not value trustworthiness are characterized by widespread “groupthink” and employees who raise concerns about high-risk behavior in such institutions are routinely ignored by senior leaders (Stiroh, 2020, p. 1). Such banks suffer reputational damage themselves, while also diminishing overall “trustworthiness of the industry over time” (Stiroh, 2020, p. 1). Banks with cultures that value trustworthiness are characterized by employees’ unwillingness to engage in excessive risk-taking, employees’ commitment to behaving lawfully, and senior managers’ commitment to encouraging employees to escalate risk-related concerns (Stiroh, 2020, p. 1). Banks with cultures that value trustworthiness earn reputations as trustworthy institutions and foster overall trustworthiness in the banking industry.

What's Next?

The banking industry's trustworthiness—or untrustworthiness—has the power to positively or adversely impact the lives of individuals and the power to enhance or diminish the stability of the global economy (Dia, 2011; Egan, 2017; FSB, 2010). Three lines of defense professionals have an opportunity, and an obligation, to foster trustworthiness in the banking industry by meaningfully challenging each other and their bank's established practices. Industry leaders have an opportunity, and an obligation, to empower three lines of defense professionals to foster trustworthiness by investing in hiring, retaining talent across the lines, and actively fostering a culture that values trustworthy behavior. Every employee across every bank has an opportunity, and an obligation, to approach their work in a trustworthy manner every day. Survey respondents in this study consistently echoed one sentiment with especially strong conviction: The Three Lines of Defense Model, and ultimately the banking industry, is only as good as its people.

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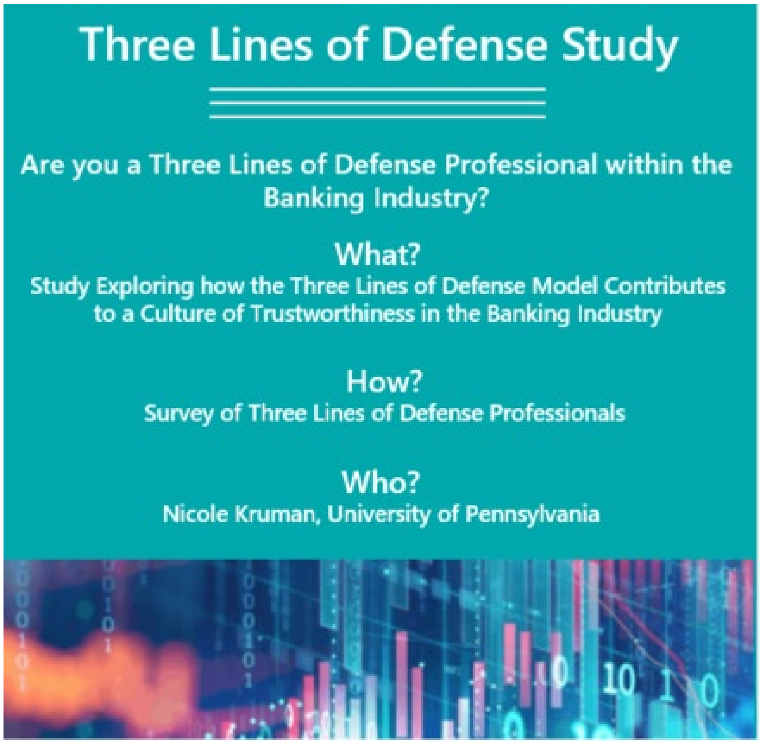
APPENDIX

Recruitment Flyer



Recruitment Script

My name is Nicole Kruman and I am a graduate student at the University of Pennsylvania in the Organizational Dynamics program. To fulfill my program requirements, I am completing my capstone research project, which explores the role of the Three Lines of Defense Model in contributing to a culture of trustworthiness in the banking industry (Cocheo, 2014; Lim et al., 2017). I will conduct this research through the analysis of survey results, academic literature, industry white papers, and regulators' publications.

I am personally drawn to this research because of my role in the First Line of Defense within a G-SIB (Global Systemically Important Bank). I am surveying professionals who work (or have previously worked) in the Three Lines of Defense within the banking industry because I am especially interested in analyzing their first-hand experiences. While there is academic literature, industry white papers, and regulators' publications on the Model, my research objective is to integrate theoretical and practical research as a whole (Office of the Comptroller of the Currency, 2014; Lim et al., 2017; Daisley et al., 2015).

A trustworthy banking industry is an absolutely vital component to a thriving global economy (Dia, 2011). By analyzing the results of this survey, I hope to identify ways in which the Model can be leveraged more effectively to contribute to a culture of trustworthiness in the industry. In addition to closed-ended questions, this survey provides several open-ended text boxes. I encourage you to share your feedback in these text boxes, so I can more fully understand your experiences and insights.

To participate in this 20-minute confidential survey you must currently work (or have previously worked) in the Three Lines of Defense Model within the banking industry. The survey does not require you to disclose any aspect of your personal identity or that of your employer. Should you choose to disclose any identifying information about yourself or your employer in your responses to open-ended questions, this identifying information will not be referred to in any way during the course of my research. No one other than myself will have access to your survey and all related information will be stored on my password-protected computer.

I will be completing this research under the guidance of Dr. Kimberly Torres at the University of Pennsylvania. Professor Torres is a faculty member in the Organizational Dynamics program.

If you are interested in participating in my study, please complete this 20-minute confidential survey: [Qualtrics Survey Link]

If you're interested in learning more about this study, please feel free to email me at nicolekr@sas.upenn.edu.

Thank you for your participation. Your contribution to this research study is truly appreciated.

Participant Consent Form

By consenting to be part of this research, you agree to participate in a 20-minute survey. This is a research study; therefore, there will be no direct benefits to you from participation in the study. It is hoped that the findings of this study will provide some understanding of the role of the Three Lines of Defense Model in contributing to a culture of trustworthiness in the banking industry. Your participation is completely voluntary.

The survey does not require you to disclose any aspect of your personal identity or that of your employer. Should you choose to disclose any identifying information about yourself or your employer in your responses to open-ended questions, this identifying information will not be referred to in any way during the course of my research. Should I plan to continue this study at a later date, the data from this research will be de-identified, and could be stored and distributed for future research.

There are minimal risks to you from taking part in this survey. The risk is accidental disclosure of private information. However, every effort will be made, within the limits of the law, to safeguard the confidentiality of the information you provide. No one other than myself, Nicole Kruman, will have access to the information on your survey. No identifying information related to respondents will be referenced at any point in time throughout the course of this research. All related information will be stored on my password-protected computer.

Should I plan to continue this study at a later date, the data from this research will be de-identified, and could be stored and distributed for future research. You may choose not to answer any question that you do not want to answer and are free to terminate the survey at any time. Should you decide to terminate your survey and/or involvement in this study, I will destroy all related information. You will not be linked to my research in any way thereafter. You understand that all information collected in this study will be kept strictly confidential, except as may be required by law. Because of the confidential nature of the research, there will be no witness to consent procedures.

Subject Rights: If you wish to have further information regarding your rights as a research subject, you may contact the Director of Regulatory Affairs at the University of Pennsylvania by telephoning 215-898-2614. You have been given the opportunity to ask questions and have had the answered to your satisfaction. You have read and understand this consent form.

○ I consent to participate in this study

○ I do not consent to participate in this study

(Skip to end of survey if “I do not consent to participate in this study” is selected)

Survey

1) Do you currently work (or have you ever worked) in the Three Lines of Defense Model within the banking industry?

○ Yes

○ No

(Skip to end of survey if “No” is selected)

2) How many years have you worked in the First Line of Defense (Line of Business), including your current role if applicable?

○ 0

○ <1

○ 1-5

○ 6-10

○ 11-20

○ 21+

3) How many years have you worked in the Second Line of Defense (Compliance), including your current role if applicable?

- 0
- <1
- 1-5
- 6-10
- 11-20
- 21+

4) How many years have you worked in the Second Line of Defense (Risk), including your current role if applicable?

- 0
- <1
- 1-5
- 6-10
- 11-20
- 21+

5) How many years have you worked in the Third Line of Defense (Internal Audit), including your current role if applicable?

- ◯ 0
- ◯ <1
- ◯ 1-5
- ◯ 6-10
- ◯ 11-20
- ◯ 21+

6) How many years have you worked as an External Auditor, including your current role if applicable?

- ◯ 0
- ◯ <1
- ◯ 1-5
- ◯ 6-10
- ◯ 11-20
- ◯ 21+

7) How many years have you worked as a Regulator, including your current role if applicable?

○ 0

○ <1

○ 1-5

○ 6-10

○ 11-20

○ 21+

8) If you have worked in a role in the Three Lines of Defense Model within the Banking Industry, however the role was not described in any of the previous questions, please describe the role.

(Skip to question 10, if question 8 is empty)

9) How many years have you worked in the role you described in the previous question, including your current role if applicable?

○ 0

○ <1

○ 1-5

○ 6-10

○ 11-20

○ 21+

10) If you are currently working in the Three Lines of Defense Model, what is your current role?

○ First Line (Line of Business)

○ Second Line (Compliance)

○ Second Line (Risk)

○ Third Line (Internal Audit)

○ External Audit

○ Regulator

○ Not Currently Working in the Three Lines of Defense Model

○ Current Role is Not Described in the Options Provided

(Skip to question 12 if “Current Role is Not Described in the Options Provided” is *not* selected)

11) If you currently work in a role in the Three Lines of Defense Model within the Banking Industry, however the role was not described in the options provided in the previous question, please describe the role.

12) How many banks have you been employed by which implemented the Model, including your current employer if applicable?

○ 1

○ 2

○ 3

○ 4

○ 5+

○ N/A (e.g., Regulators, External Auditors)

(Display question 13 if the answer to question 12 is *not* "N/A")

13) Is your current employer a bank?

◯ Yes

◯ No

(Skip to question 15 if answer to Question 13 is "No")
(Display question 14 if the answer to question 13 is "Yes")

14) Is your current employer a Global Systemically Important Bank (G-SIB) or a bank that is *not* a G-SIB? (For a list of G-SIBs, please refer to this page: https://www.fsb.org/wp-content/uploads/P111120.pdf)

◯ G-SIB

◯ *Not* a G-SIB

(Display question 15 if the answer to question 12 is *not* "N/A")

15) Have you previously been employed by a Global Systemically Important Bank (G-SIB)? (For a list of G-SIBs, please refer to this page: https://www.fsb.org/wp-content/uploads/P111120.pdf)

◯ Yes

◯ No

16) Have you previously been employed by a bank that is *not* a Global Systemically Important Bank (G-SIB)? (For a list of G-SIBs, please refer to this page: https://www.fsb.org/wp-content/uploads/P111120.pdf)

◯ Yes

◯ No

17) What are the key differences you've observed in the implementation of the Model at different banks that have led to more effective (or less effective) results?

18) Overall, the Model contributes to making the banking industry more trustworthy in terms of functioning more efficiently (e.g., more effective controls are in place and mistakes are minimized due to the Model).

- ○ Strongly Agree
- ○ Agree
- ○ Somewhat Agree
- ○ Somewhat Disagree
- ○ Disagree
- ○ Strongly Disagree

19) Please describe the experience (or experiences) that inform your answer to the previous question.

20) Overall, the Model contributes to making the banking industry more trustworthy in terms of ethical behavior. (e.g., a culture with high ethical standards is established and unethical behavior is minimized due to the Model).

- ○ Strongly Agree
- ○ Agree
- ○ Somewhat Agree
- ○ Somewhat Disagree
- ○ Disagree
- ○ Strongly Disagree

21) Please describe the experience (or experiences) that inform your answer to the previous question.

22) Professionals across the Three Lines constructively challenge each other, identifying and pursuing opportunities to strengthen practices within the banking industry.

- ◯ Strongly Agree
- ◯ Agree
- ◯ Somewhat Agree
- ◯ Somewhat Disagree
- ◯ Disagree
- ◯ Strongly Disagree

23) Please describe the experience (or experiences) that inform your answer to the previous question.

24) Clear and meaningful communication consistently takes place between the Three Lines.

- ◯ Strongly Agree
- ◯ Agree
- ◯ Somewhat Agree
- ◯ Somewhat Disagree
- ◯ Disagree
- ◯ Strongly Disagree

25) Please describe the experience (or experiences) that inform your answer to the previous question.

26) The division of responsibilities between the Three Lines is clear, and professionals demonstrate a commitment to fulfilling those responsibilities. (i.e., Professionals across all three lines fulfill their responsibilities, so one line does not need to overcompensate for another line's lack of commitment to the Model.)

- ○ Strongly Agree
- ○ Agree
- ○ Somewhat Agree
- ○ Somewhat Disagree
- ○ Disagree
- ○ Strongly Disagree

27) Please describe the experience (or experiences) that inform your answer to the previous question.

28) Senior leaders in the banking industry demonstrate a meaningful understanding of the Model.

- Strongly Agree
- Agree
- Somewhat Agree
- Somewhat Disagree
- Disagree
- Strongly Disagree

29) Please describe the experience (or experiences) that inform your answer to the previous question.

30) Senior leaders in the banking industry demonstrate a commitment to the successful implementation of the Model by dedicating appropriate human resources, funding, and employee training to support the Model.

- Strongly Agree
- Agree
- Somewhat Agree
- Somewhat Disagree
- Disagree
- Strongly Disagree

31) Please describe the experience (or experiences) that inform your answer to the previous question.

32) The Model's greatest strength is:

33) This strength could be fostered by:

34) The Model's greatest weakness is:

35) This weakness could be mitigated by:

36) Is there anything else you would like to share about your experiences working within the Three Lines of Defense Model?