Developments in Sustainability Accounting: The trade-offs in "Conduct Costs" Reporting

By Calvin Benedict | 2016
The author gratefully acknowledges the helpful proofreading of Franco Acchiardo in the preparation of this paper. The usual disclaimer applies.

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1.0 Introduction

The United Kingdom ('UK') banking sector's vital role in supporting the real economy and preserving its global pre-eminence has been eroded by a pervasive loss of trust beset by a decline in banking standards and multiple conduct failures (Parliamentary Commission on Banking Standards, 2013a, p.8-10). In the UK and elsewhere, these failures have been embodied in the wave of high-profile banking scandals that continue to profoundly question the efficacy of post global financial crisis reform measures. Inevitably with misconduct comes costs — this is euphemistically termed 'conduct costs'. Against this background, this paper broadly looks to sustainability accounting as a mechanism for rebuilding trust.

Since its emergence in the 1970s, the scholarly body of literature on sustainability accounting has gained considerable traction (Thomson, 2007, p.19). Unerman et al. (2007, p.3) argue that:

> "Broader techniques of sustainability accounting and accountability have the potential to be powerful tools in the management, planning, control and accountability of organizations for their social and environmental impacts. Or, in other words, for the social and environmental in addition to the more conventional economic sustainability of the organization."

Indeed, the 'greening' of accountancy has seen accounting practice develop from its traditional focus on the economic to also encompass social and environmental reporting (Hopwood et al, 2010, p.2). Accounting for conduct costs is symptomatic of social reporting.

Sustainability accounting — or for that matter 'sustainability' — is a somewhat nebulous term and several information management interpretations are offered by Schaltegger and Burritt (2010, p. 379-380):

I. An empty buzzword tantamount to a public relations exercise.
II. A broad umbrella term amalgamating existing accounting and reporting approaches dealing with environmental, social and eco-efficiency challenges. A problem with this interpretation is that it reflects certain conceptual confusions with the basic idea of sustainable development (as popularised by a Brundtland Commission report in 1987) and results in a misuse of terms. For instance, when the word 'sustainability' is used interchangeably with the word 'environmental' (accounting), this represents an inattention towards 'social' accounting.
III. An overarching, comprehensive measurement and information tool for calculating all aspects of corporate sustainability within one measure. Taking into account the multi-dimensional character of sustainability, and the different goals and stakeholders involved, this approach remains a technocratic illusion.
IV. A pragmatic, goal driven, stakeholder engagement process which attempts to develop a set of tools. These tools are designed to measure and report on environmental, social and economic dimensions, as well as the links between them. This includes information on linkages and aspects of corporate sustainability, eco-efficiency, stakeholder value and increases in shareholder wealth emanating from corporate citizenship.

We shall expand on the last interpretation: the pragmatic process development approach. A pragmatic approach dictates that sustainability is a real and tangible corporate challenge, not just an abstract construct (Schaltegger and Burritt, 2010, p.381). Hence, the description and measurement of sustainability performance must be of *relevance* in a given corporate and management setting, i.e., the institutional environment (Schaltegger and Burritt, 2010, p.381).

Schaltegger and Burritt (2010, p.382) discuss three basic approaches of this pragmatic interpretation of sustainability accounting: the top-down approach, the stakeholder driven approach, and the twin track approach. Conduct costs disclosure exemplifies the twin track approach; insofar as it combines stakeholder issues (e.g., social acceptance and reputation requirements) with top-down issues (e.g., the strategic goals and competitive strategy of banks relating to major sustainability issues). This paper is primarily concerned with stakeholder issues.

In their concluding statements, Schaltegger and Burritt (2010, p.382) affirm that both the development of a pragmatic set of tools for corporate practice; and the linkage between sustainability accounting and sustainability reporting to elicit behavioural changes within corporations is still at an early stage of development. In this present context, they perceive sustainability reporting to be more of a buzzword as opposed to a well-defined approach (Schaltegger and Burritt, 2010, p.382). This paper specifically answers the call to a well-defined approach and analyses the trade-offs in conduct costs reporting, as a pragmatic sustainability accounting tool, to rebuild trust in the banking sector.

The research presented in this paper is based on the Conduct Costs Project ('Project') that is carried out by CCP Research Foundation CIC ('Foundation'). McCormick (2015a, p.107-108), founder of the Project which was launched at the London School of Economics ('LSE'), contextualises its sustainability origins:

> "Many questions that commentators were asking about 'sustainability' in financial markets were ignoring a key, even fundamental, question: can the financial system ever achieve worthwhile sustainability goals if the business models of banks, and their behaviour, are not themselves sustainable? ...We wanted to correct that oversight. We wanted the culture and conduct of banks to be brought to account when their 'sustainability' (and that of the financial system) was assessed. To this end, we felt we needed to devise some reasonably objective (or 'concrete') indicators of bank behaviour and work out how the behaviour of one bank could be compared with that of another."

2.0 Conduct costs: The importance of a shared definition

The term conduct costs describes the direct financial consequences of misconduct or, more widely, of the crystallisation of "conduct risk" (Stears and McCormick, 2015, p.176). Conduct risk — a relatively recent focus of the Financial Conduct Authority ('FCA') — is normally associated with risks pertaining to how a corporation and its staff conduct themselves, in addition to the manner in which customers and investors are treated (European Systemic Risk Board, 2015, p.4; FCA, 2013a). In its idealised conception, conduct costs seeks to quantify the direct costs of misconduct in the banking sector. These costs include fines and/or penalties imposed by regulators as evident by the enormous fines meted out in the Libor Interbank Offered Rate ('Libor') and foreign exchange market ('Forex') scandals. But they also refer to a wider array of misconduct-related costs, including (McCormick, 2014; Foundation, 2014a; Foundation, 2015a):

I. sums in the form of compensation to customers who have been mis-sold financial products such as payment protection insurance ('PPI');
II. disgorgement of profits; and
III. the cost of repurchasing (at par) securities that were 'mis-sold' to the market, as occurred with several auction rate securities sold in the United States.

McCormick and Stears (2014, p.137) point out that although there is no generally accepted definition of conduct costs, the term ought to objectively cover behaviour that impugns the integrity and good standing of a bank. This amounts to a principles-based approach, where discretion is sometimes needed. The approach appears to be validated by the observation that misconduct issues are so vast in scope and nature that a bright line rules-based approach seems neither plausible nor desirable.

It is as this stage that a caveat must be sounded: the definition and data discussed here, due largely to data constraints, do not include "indirect" conduct costs like (Stears and McCormick, 2015, p.179):

I. the costs associated with additional compliance staff to cope with current and future claims;
II. the costs of hiring lawyers in response to claims;
III. the costs of management time; and
IV. intangible costs as it relates to a bank's brand and reputation.

Further, the scope of the definition is not limited by accounting materiality (which provides a threshold for corporate disclosure) but is limited by the accounting entity principle (which ignores any externality that does not impact on an entity's financial performance or position). That is, misconduct is only captured by the definition to the extent that it crystallises into a costs, which impact on a bank's financial position or performance. In this respect, the term runs with the grain of conventional reporting recognition criteria and does not challenge the *extent* to which a bank recognises externalities related to misconduct.

The concept of conduct costs and its use in the lexicon of finance is exceptionally important in the sustainability discourse of banks, not least because of the increasingly mediatised environment in the UK. It is imperative that conduct costs does not morph into a 'broad umbrella term' that allows for ambiguity. Lessons can be drawn from environmental reporting. Hopwood (2009, p.438) reasoned that, in 2008, Shell was fined by the British Advertising Standards for taking advantage of multiple definitions of sustainability to imply an arguably *non-existent* positive environmental aim for its investment in Canadian Tar sands. For sure, the fabled power of the press, as a democratising agent of transparency and public accountability, should not be underestimated. However, the financial press has sometimes used the term conduct costs interchangeably with other terms such as "fines" and "legal costs" (Kollewe et al. 2014; McLannahan, 2015). Two clarifications can be made in this regard.

Firstly, a preliminary analysis by Stears and Duarte (2015, p.1) looking at the four major UK banks — i.e., HSBC, Royal Bank of Scotland ('RBS'), Lloyds Banking Group ('Lloyds') and Barclays — has resoundingly confirmed that conduct costs as a metric is not simply a matter of fines and/or penalties. Stears and Duarte (2015, p.2-4) conclude that fines and penalties for the four major UK banks between 2008 and 2013 account for approximately 13.68% of the total conduct costs, and thus form a "relatively small (albeit material) part of the bigger 'Conduct Costs' story". Stears and Duarte (2015a, p.1-3) have produced the ensuing graphs applying three different "Cost Codes" based on these working definitions:

- "**'FNE'**, being Fines and/or Penalties imposed by a regulatory and/or other 'Conduct' authority.
- **'RCC'**, being 'Conduct Costs' that arise out of a regulatory directed redress, whether or not it results in formal proceedings, fines or penalties (Other than FNE).
- **'OCC'**, being all Other 'Conduct Costs'."

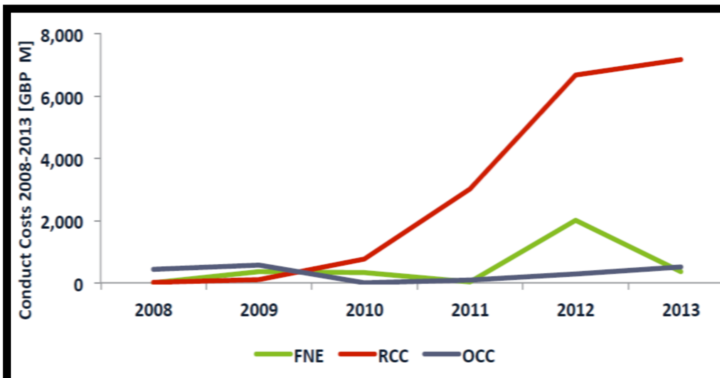


Figure 1 – Conduct Costs for the period 2008-2013, for the UK banks (Barclays, HSBC, Lloyds Banking Group and RBS).

b) Each bank

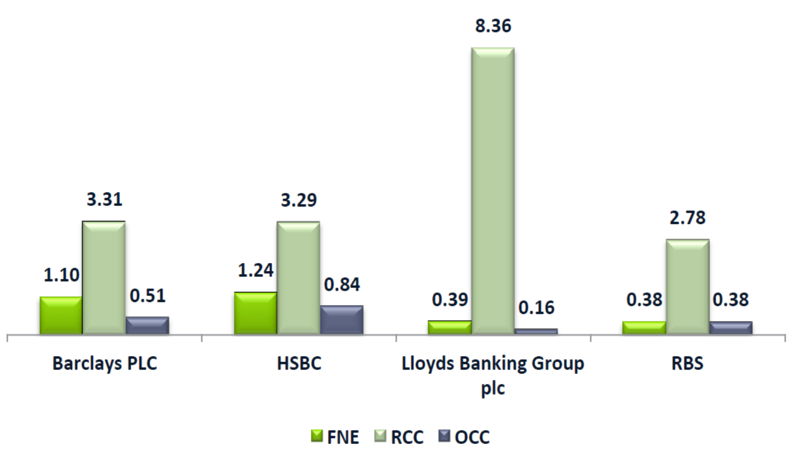
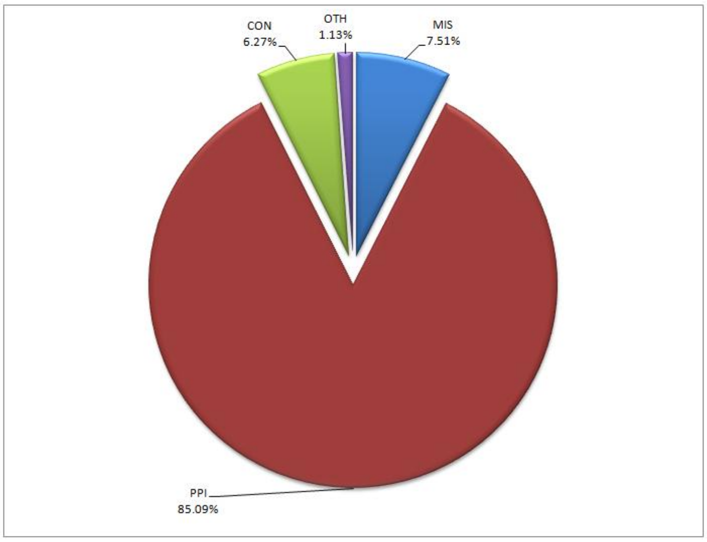


Figure 4 – Conduct Costs for the period 2008-2013, categorized by Cost Code (FNE, RCC and OCC) and by UK bank, in GBP Bn.

From Figure 4, we can see that Lloyds has the biggest ratio of RCC to FNE, and that according to Figure 1 the divergence between RCC and FNE dramatically increased from 2010 to 2013. As a corollary thereto, we can establish what is driving this divergence by carrying out a drill-down analysis of 'RCC' from the conduct costs data for Lloyds between 2010 and 2013. (The data and associated results can be verified upon request by the Foundation.) The results of the pie chart below are unequivocal: the most prevalent 'RCC' for Lloyds for the period in question relates to redress liability from the mis-selling of PPI. This is, of course, in line with expectations as Lloyds has incurred the highest PPI redress liability in comparison to the other UK banks between 2010 and 2014 (Treanor, 2015a). At least for Lloyds, it is clear that between 2010 and 2013 the biggest driver of conduct costs was PPI redress liability — not fines and/or penalties. The FCA has indeed issued fines in relation to PPI; however, the 'RCC' data referenced here does not relate to fines.

Drill-down analysis of Lloyds 'RCC' (2010 - 2013)



Note to chart:
'PPI' — Payment Protection Insurance
'CON'— Defective internal controls
'MIS' — Mis-selling other than PPI
'OTH' — Miscellaneous category for other events including governance and management failures

Secondly, the term legal costs can be viewed as carrying a lesser reputational and ethical connotation than conduct costs. Indeed, some of these costs should be recognised as ethical failures, with different degrees of culpability (McCormick et al., 2015b). Of paramount concern, is that legal costs implicitly conflate misconduct issues with other legally-related, non-conduct issues. Conceptual clarity is vital if banks are to be prevented from engaging in 'greenwashing' by masking their misconduct failings in ostensibly neutral language. For these reasons conduct costs like other principles-based terms, ought to be ideally underpinned, as Black (2008, p.438) opines, by operative communities of "shared understanding" and be used consistently in its application.

3.0 Regulatory endorsement: steps towards an industry-wide definition

In June 2014, the Fair and Effective Markets Review ('FEMR') was launched by the Chancellor of the Exchequer and the Governor of the Bank of England ('BoE') to strengthen confidence in the wholesale Fixed Income, Currency and Commodities ('FICC') markets (FEMR, 2015, p.5). The FEMR (2015, p.5) represents the joint efforts of the BoE, HM Treasury and FCA. Its establishment followed evidence of harmful misconduct in recent years that damaged public trust (FEMR, 2015, p.5). As the FEMR (2015, p.5) emphasises, the FICC markets are vast; with daily turnover in foreign exchange markets around US$5 trillion and the FICC 'over the counter' derivatives have an estimated notional value of US$620 trillion. More fundamentally, these markets establish the borrowing costs of households, companies and governments, in addition to determining the costs of food and raw materials (Carney, 2015a, p.3).

In October 2014, a consultation document by the FEMR (2014) examined the fairness and effectiveness of the FICC markets. The document cited the Project's data in its chart on FICC related fines and proposed the following performance measure (FEMR, 2014, p.43):

> "A single, objective, industry-wide definition of costs arising from misconduct and its transparent disclosure in firms' annual (and/or corporate social responsibility) reports could also be explored as a way of incentivising improved ethical behaviour across the FICC sector."

The footnote related to the above citation suggested that the work of the Project and the Foundation could provide a framework for further development in relation to industry-wide performance measures concerning conduct (FEMR, 2014, p.43).

The Final Report of the FEMR (2015, p.72) further concluded that:

> "Historically, FICC market participants appear not to have put sufficient weight on the importance of measuring and addressing issues of poor conduct ...Increased public awareness of firms' conduct — both good and bad — may also help to align the incentives of executives, shareholders and other investors, not least by bringing competitive pressure to bear. Currently, there are challenges in collating data on fines levied on firms in a consistent way. Fines are published in different ways by different regulators, and firms are under no obligation to disclose conduct costs, often aggregating fines with other legal costs in their annual reports. Greater clarity in reporting by firms would help shareholders monitor progress on conduct issues."

The FEMR (2015, p.73) rightfully notes, though, that much of the work on credible conduct metrics is at an early stage but sees the potential in a collaborative approach across industry to hasten progress. Such an endorsement encourages the scope for a shared understanding of conduct costs. However, one of the common pitfalls of not mandating disclosure is that a voluntary disclosure system generally results in idiosyncratic reporting. Accordingly standardisation is needed to improve comprehensibility and comparability, and moderate the underproduction of information. The 'Conduct Costs Report' ('CC Report'), as discussed below, provides a framework for standardisation.

4.0 League tables: The escalating magnitude of conduct costs

Turning now to the escalating magnitude of conduct costs. A league table that has been produced by the Foundation (2015a) estimates the conduct costs for 16 major international banks for the 5-year period from 2010 to 2014, including provisions as at the end of 2014: (The Foundation publishes these tables in May and/or June each year, and its members have access to the underlying data.)

International Results Table (2010-2014)

Banks	Total Costs 2010-2014 (GBP bn)	Provisions as at 31 Dec 2014 (GBP bn)	Grand Total 2010-2014 (GBP bn)	Grand Total 2009-2013 (GBP bn)	Relative Position to 2009-2013	*Grand Total 2008-2012 (GBP bn)*
BAC	55.80	8.25	64.05	66.40		*54.00*
JP Morgan Chase & Co	28.65	4.26	32.91	35.78		*24.65*
Lloyds Banking Group plc	12.24	3.38	15.62	12.72		*9.24*
Citigroup, Inc	12.17	2.58	14.75	7.57	(+2)	*11.84*
Barclays PLC	8.00	4.59	12.59	7.89		*5.06*
RBS	6.79	4.11	10.90	8.47	(-2)	*4.24*
Deutsche Bank	6.01	3.37	9.38	5.62	(+1)	*3.95*
HSBC	6.39	2.29	8.68	7.21	(-1)	*6.25*
BNP Paribas	6.04	1.72	7.76	3.54	(+4)	*1.89*
Santander	3.87	3.07	6.94	3.57	(+2)	*4.14*
GS	4.05	2.08	6.13	3.65	(-1)	*3.95*
Credit Suisse	4.01	1.84	5.85	3.58	(-1)	*3.00*
UBS	3.42	1.99	5.41	4.18	(-4)	*24.65*
National Australia Bank Group	1.83	1.00	2.83	2.34		*2.19*
Standard Chartered Bank	0.96	0.05	1.01	0.76		*0.75*
Société Générale	0.08	0.86	0.94	0.70		*1.28*
Grand Total [GBP Bn]	**160.31**	**45.44**	**205.75**	**173.98**		***161.08***

International Results Table

Similarly, the Foundation has produced a league table for the 5-year period from 2009 to 2013 (available upon request):

Banks	Total Costs 2009-2013 (GBP bn)	Provisions as at 31 Dec 2013 (GBP bn)	Grand Total 2009-2013 (GBP bn)	*Grand Total 2008-2012 (GBP bn)*	Relative Position to 2008-2012
BAC	39.09	27.31	66.40	*54.00*	
JP Morgan Chase & Co	26.61	9.17	35.78	*24.65*	(+1)
Lloyds Banking Group plc	8.91	3.82	12.72	*9.24*	(+2)
RBS	3.55	4.92	8.47	*4.24*	(+4)
Barclays PLC	4.88	3.01	7.89	*5.06*	(+2)
Citigroup, Inc	4.55	3.02	7.57	*11.84*	(-2)
HSBC	4.97	2.24	7.21	*6.25*	(-1)
Deutsche Bank	3.87	1.75	5.62	*3.95*	(+2)
UBS	3.08	1.10	4.18	*24.65*	(-7)
GS	1.48	2.17	3.65	*3.95*	(+1)
Credit Suisse	2.00	1.58	3.58	*3.00*	(+1)
Santander	2.42	1.14	3.57	*4.14*	(-3)
BNP Paribas	0.62	2.92	3.54	*1.89*	(+1)
National Australia Bank Group	2.01	0.33	2.34	*2.19*	(-1)
Standard Chartered Bank	0.71	0.05	0.76	*0.75*	(+1)
Société Générale	0.12	0.58	0.70	*1.28*	(-1)
Grand Total [GBP Bn]	**108.87**	**65.11**	**173.98**	***161.08***	

International Results Table

When the 2010-2014 period is contrasted with the 2009-2013 period, the research signifies that incurred conduct costs increased by 47.25% (from £108.87 billion to £160.31 billion). Adding £45.44 billion for conduct costs-related provisions (and contingent liabilities) this results in a grand total of £205.75 billion for the 2010-2014 period. The grand total, when compared with the 2009-2013 period, equates to an increase of 18.26% (from £173.98 billion to £205.75 billion).

Some banks have sought to attribute their exorbitant conduct costs to clearing up legacy issues originating from the global financial crisis (Arnold, 2014). However, this obfuscates costs from recently uncovered misconduct, e.g., in the Forex scandal, the FCA fined banks for inappropriate behaviour that persisted up until October 2013 (Arnold, 2014). A promising sign for these banks, however, is that their conduct costs-related provisions (and contingent liabilities) between the two five-year periods have fallen by 30.21% (from £65.11 billion to £45.44 billion). Nevertheless, the provisioning must be treated with caution as banks have been found liable to sometimes significantly under-provision: for instance, BNP Paribas' provisioning accounted for only 12.4% of its US$8.9 billion fine in 2014 (Benedict, 2014a, p.4).

4.1 Meaning behind the numbers: Systemic risks

These figures provide credibility to a letter written by Mark Carney, Governor of the BoE, to G20 Finance Ministers and central bank governors where he pointedly wrote that the scale of misconduct in some financial institutions may produce "systemic risks" (Carney, 2015b, p.3). Carney (2015a, p.6) estimates that US$150 billion in fines levied on banks reduces the lending capacity to the real economy by more than US$3 trillion. Recognising that misconduct poses risks to systemic stability, the BoE (2015a, p.39) has amended the 2015 stress test of the UK banking sector to include an assessment of "potential future costs related to past misconduct" for both baseline and stress projections. Specifically, banks' baseline prudential estimates of "all potential costs relating to misconduct risk" should be determined, irrespective of the recognition of existing IAS 37 provisions (BoE, 2015b, p.10). As an aside, a prudential supervision definition of (mis)conduct risk — whether by the BoE or another authority — may adopt a much narrower interpretation than described earlier; where conduct risk is, for instance, classified as a subset of operational risk (European Systemic Risk Board, 2015, p.4).

The European Systemic Risk Board ('ESRB') has investigated the potential systemic consequences of misconduct (ESRB, 2015). The ESRB (2015, p.5) find that increasing conduct costs incite uncertainty in the "business model, solvency, and profitability of banks". Ultimately, such costs may provoke a withdrawal from financial markets and activities by a systemically important bank that threatens the stability of a particular market (ESRB, 2015, p.5). This is certainly plausible, given HSBC's warning that, at one stage, it was considering relocating its headquarters outside the UK because of "regulatory and structural reforms" (Treanor, 2015b, p.1). In response to misconduct issues, the Financial Stability Board (2014, p.1) has focused on anticipatory approaches that reinforce a sound risk culture in banks. Preventative measures are essential; but to come full circle it is equally apposite to have assessment and modification processes. As the Financial Stability Board (2014, p.3) avow: "Assessing risk culture is complex. But given its importance attention must be paid to it." Insofar as conduct costs as tail events reveal weaknesses in risk culture, it can facilitate these processes.

4.2 Assumptions and the evolutionary step of the league tables

The league tables are based on data sourced only from the public domain, i.e., what shareholders and wider stakeholders have access to (Foundation, 2014a). The 5-year rolling periods provide a ready basis for trend analysis and limit the effect of outliers. The tables are based on a number of assumptions and techniques.

Firstly, due to the difficulty of tracing through provision-adjustments between each year and to avoid the risk of double counting within the rolling 5-year period, for the 2010-2014 table only the provisions made in the 2014 reporting period are included (Foundation, 2014a). In this way, for the next 2011-2015 table, the provision figures stated in the 2010-2014 table are removed and replaced by provisions made in the 2015 reporting period.

Secondly, the figures over the 5-year period for conduct costs that have crystallised disregard the time value of money and are therefore not wholly compatible to the provisioning liability as at 31 December.

Thirdly, the league tables do not cover all banks, but rather those seen as household names and significantly important in their respective jurisdictions. Thus, the total conduct costs incurred by all banks globally will, of course, exceed the figures presented above. Nevertheless, not all banks need to be covered to perceive the escalating magnitude of the conduct crisis that has taken hold.

Fourthly, comparability is limited as banks are of different sizes, use bespoke business models, and operate in jurisdictions with varying enforcement intensities (Foundation, 2014a). Conversely, it could be equally asserted that a *baseline* comparison is created to sharpen engagement: when shareholders and wider stakeholders trying are to distinguish if a particular conduct cost relates to a bank-specific or industry-wide problem, the burden of explanation arguably lies with banks to explain the differences. Banks have hitherto failed to do so.

Finally, a report by Lambert (2014, p.16), which set out recommendations for the Banking Standards Board, rejected the use of league tables as he claimed that they lend themselves to gaming with no apparent explanation. Besides the fact that this claim indirectly conflicts with the FEMR's recommendation for increased public awareness of conduct costs, there are two further counterarguments that strike with force. The Foundation's league tables are fundamentally based on accounting disclosures in annual reports and, even though there is room for interpretation as to what constitutes conduct costs, banks are extended an open invitation to consult on the findings (Foundation, 2014a). This feedback process means gaming — as it relates to the above league tables — is arguably attenuated to a minor issue. Ignoring this, the gaming criticism misses the bigger picture: sustainability accounting is in a constant development process. The league tables are part of an evolutionary reform process to get banks to take up the mantle themselves: by producing their own CC Report (as explored below). The tables are simply a starting point to show that it is *possible* for banks to develop a pragmatic sustainability accounting tool to measure their misconduct that allows for industry benchmarking.

5.0 A positive analysis: The reporting of conduct costs by banks

No specific banks are identified so as to give a general overview of disclosure practices.

At present, banks do not report conduct costs in a clear, consistent or readily understandable format (Foundation, 2015b, p.3). Nor are the indirect conduct costs described above typically disclosed (Foundation, 2015b, p.3). It is submitted that some conduct-related matters are outlined within the notes to financial statements but there is generally little — or at best, sporadic — reporting of the actual costs of misconduct (Foundation, 2015b, p.3). In any case, there is no specific, comprehensive reporting of total conduct costs within a bank's financial statements, sustainability (or equivalent) reports, or public relations releases (Foundation, 2015b, p.3).

Accounting research pioneered by the Foundation (2015b, p.4) has revealed that often the best available proxy for total conduct costs are "provisions utilised" figures as reported within the notes to the financial statements. The problem, however, is that these utilised provision figures relate to broader categories which, by definition, may include non-conduct costs — e.g., 'Operational risk events', 'Other', 'Disputes', 'Customer Remediation', 'Legal Proceedings', 'Regulatory Matters', 'Litigation' etc. To provide greater granularity to the research, where possible, the Foundation reconciles the utilised provision sums with any verifiably sourced, third party data such as fine notices (Foundation, 2014a). Even if more information is disclosed on conduct-related matters, it is next to impossible to fully reconcile these with the aggregated utilised provision sums (Foundation, 2014a). As one example, if a bank discloses that it has made a provision of £20 million for a class action (for, say, the mis-selling of financial products) and if 'Other' provisions of £40 million is determined as the best available proxy for conduct costs, then it may not be clear as to whether the remaining £20 million relates to conduct costs. In echoing terms, the European Banking Authority (2014, p.53) highlighted this sort of disclosure practice in the European banking system:

> "Banks often do not capture specific litigation provisions, but appear, rather, to make general provisions which are internally marked for litigation purposes, often on a probability weighted basis for a range of potential conduct costs."

Similarly, the European Banking Authority (2013, p.36) has expressed concerns as to whether conduct risk is adequately provisioned for, and whether there is a lack of detail for provisions disclosed. For the purposes of IAS 37, the European Banking Authority (2013, p.36) has underlined that the classification of risks and related disclosures (in provisions and contingent liabilities) allows for variations in interpretation. Accordingly, the European Banking Authority (2013, p.36) concluded that the accounting treatment of actual and potential conduct costs like the costs of redress is not always consistent between banks — even when they face similar risks.

In terms of sustainability reporting, most banks follow the Global Reporting Initiative ('GRI') framework in accordance with the G4 Sustainability Reporting Guidelines (GRI, 2013). The guidelines have three notable conduct-related indicators:

I. G4-EN29 (environmental indicator) — "Monetary value of significant fines and total number of non-monetary sanctions for non-compliance with environmental laws and regulations" (GRI, 2013, p.62);
II. G4-SO8 (social indicator) — "Monetary value of significant fines and total number of non-monetary sanctions for non-compliance with laws and regulations" (GRI, 2013, p.78); and
III. G4-PR9 (product responsibility indicator) — "Monetary value of significant fines for non-compliance with laws and regulations concerning the provision and use of products and services" (GRI, 2013, p.83).

However, in practice, banks are able to side-step from providing any meaningful disclosures under these indicators by referring back to the financial statements which, as outlined above, do not transparently report on conduct costs (Foundation, 2015b, p.5). In sum, it is very challenging to estimate a single bank's conduct costs, and virtually impossible to calculate the precise or 'true' level of a bank's conduct costs based on public disclosures. The league table figures can be considered as best estimates; but they are, in essence, estimates for costs that are considered to entail systemic risks.

6.0 A normative prescription: Reforming the reporting of conduct costs

In line with the FEMR's endorsement, the Foundation has released a framework for more transparency in conduct costs. The framework petitions for banks to adopt a clear definition of conduct costs, and that these costs should be disclosed fully in one place in a bank's annual report with no reliance on cross-referencing (Foundation, 2015c, p.2). More precisely, the Foundation (2015c, p.2-3) proposes the production of a standardised CC Report which, amongst other things, should include:

I. Details of all conduct costs that have been incurred during the year (e.g., following a settlement), regardless of when the bank pays or makes a provision for it. A bank should not use aggregation except for negligible conduct costs of less than £10,000. Either way, conduct costs should not be pooled together with non-conduct costs (e.g., by grouping items together as 'legal costs' or 'litigation').
II. Details on all 'significant' conduct costs incurred in the previous two reporting periods (e.g., where the cost is greater than £1,000,000 or involves a criminal offence).
III. The total conduct costs for the reporting period (akin to the single total remuneration figure for directors).
IV. The total conduct costs for a rolling 5-year period ending 31 December of the reported year.
V. Management's estimates of indirect costs to any misconduct reported (and not captured by the definition of conduct costs) such as the cost of increasing compliance staff to cope with a misconduct event and its repercussions.
VI. A detailed itemisation of all amounts included in any provisions that relate to anticipated conduct costs.

The CC Report should allocate responsibility for conduct cost reductions to a member of the board of directors, and include a report by this individual on their plans to reduce these costs (Foundation, 2015c, p.3). Producing the CC Report will likely require changes to a bank's internal controls and systems, at an organisational and technical level. But it should be stressed that such internal changes are not revolutionary in nature. In the same way, for environmental reporting Macve (1997, p.188) observed that clear lines of responsibility should be established by management on environment matters and a board member given overall responsibility for such issues.

Let us now engage with foreseeable impediments to a CC Report. Lambert (2014, p.16) has put forward a classic boilerplate disclosure argument:

> "Disclosure is not an objective in itself. The annual reports of big banks now run to several hundred pages, and it would be difficult to argue that the vastly increased size of these documents has led to a much greater understanding of each bank's business."

In an ideal setting, disclosure is a non-interventionist and flexible instrument that still allows for firm autonomy (Ferrarini et al., 2010, p.86). The boilerplate criticism validly conveys that disclosure alone is not enough; it should conceptually allow for a straightforward analysis of performance. The CC report is cognisant to this concern: transparent conduct costs reporting should allow banks' shareholders and wider stakeholders to better assess how they have managed their conduct performance and/or risk, and the extent to which this has eroded capitalisation and profitability. To reiterate, this has implications for wider financial stability.

This optimism for disclosure must, however, be moderated by its ability to create a layer of perverse incentives that may lead banks to focus on conduct risk and/or costs at the expense of other burgeoning risks. Thus, the argument for a CC Report should not be seen as a one-shot, static disclosure reform. Rather such a report should be also subject to a continuous review and modification process — the directors' remuneration report and its varying amendments over the years providing a tangible basis for this prescription.

Borrowing more insights from reforms in the disclosure of directors' remuneration, when the UK government proposed a single figure for total remuneration, investors expressed the concern that a single figure could not provide all the information they required (Financial Reporting Council, 2012, p.3). Likewise, a greater emphasis on making the quantification of misconduct more transparent should not *ipso facto* substitute for supplementary qualitative disclosures. This, too, is accommodated by the CC Report in its stipulation of narrative details.

The CC Report should additionally be recognised for its realistic value: the idea that it can serve as a single overarching measure for restoring public trust is a technocratic illusion. Attention should still be concentrated on the prevention of misconduct as suggested by the FSB. Like environmental reporting, even if banks produce a CC report this should not act as a corporate veil that simultaneously creates a new conduct-conscience face to outsiders, whilst shielding its inner workings from external view (Hopwood, 2009, p.437). In the end, the CC Report has the potential to play a part — perhaps, an important one — in reforming the behaviour of banks, and not provide a thin veneer of justification for misconduct (and related costs) to continue just as in recent years.

On one view, banks are able to hide the true extent of their conduct costs in plain sight under the guise of an accounting materiality test. Therein lies a fundamental line of questioning: Should materiality serve as a driver for conduct costs reporting? Does the proposal for a CC report require a materiality test of some form? We adopt an alternative line of reasoning; expanding on the aforementioned proposition of Schaltegger and Burritt that the description and measurement of sustainability performance must be of relevance within the institutional environment. This reasoning is based on Power's (2007, p.95) analysis that "the accounting concept of materiality no longer applies" in light of wider regulatory influences, reputational risk management and as corporations seek to construct their legitimacy within society. Power (2007, p.95), like Schaltegger and Burritt, suggests that we should focus less on the specific "uses" of reporting and more analytically on the "social conditions", which influence the production of such reports. Notably arguments related to the 'uses' of conduct costs have already manifested in a materiality debate (Benedict, 2014b). Consequently, for the CC report, as a pragmatic sustainability accounting tool, to become an institutionalised practice we need to survey how it is of relevance within the institutional environment and hence affects the legitimacy of banks.

7.0 The banking sector's institutional environment: Constructing legitimacy through public trust

Baldwin et al. (2011, p.229) have emphasised that the development of new rules and tools need to be responsive to the institutional environmental, including the broader legal, political and social architecture. If we subscribe to this narrative then reform is as much a technical and rational calculus as an institutional art; yet, the institutional environment is in a state of flux and sometimes seemingly fickle. The parameters of this discussion are chiefly confined to one institutional characteristic: public trust. Implicit in the arguments below, we believe public trust to be a necessary precondition for the sector's long-term sustainability.

The Parliamentary Commission Banking Standards (2013b, p.105) described the UK banking sector as suffering "a collapse of trust on an industrial scale". A 'legitimacy gap' has thus arisen (due to conflicts between public expectations and the perceived performance of banks), which has translated into dialogues on the restoration of public trust. In the UK the *leitmotif* of the 'restore public trust' agenda has cemented its linchpin status in the discourse of banking reform (McCormick, 2015a, p.109). Banks are confronted with the central challenge of navigating through this dynamic institutional environment.

To help understand the notion of trust we can think of it as comprising of a three-part relation, using the writings of Gold, as described by Jaffer et al. (2014a, p.15):

> "As Natalie Gold says ...A trusts B in relation to X, where X can include both claims about the world and commitments to perform particular acts. It is important for A that B fulfil the trust, i.e. that B is trustworthy ...Trustworthiness is a feature of actions which require conscious choice: for a person [or corporation] to be trustworthy it is necessary that the person making a promise intends to keep that promise and that, when the time comes, the promise is kept in a reliable manner."

Extending this line of thought, O'Neill (2014, p.172) sees accountability and trust as going hand in hand; arguing that forms of accountability can support trust. O'Neill (2014, p.180) examines the meaning of accountability through a normative prism and counsels that intelligent systems for securing accountability comprises a conception of the type(s) of action required, and — for our purposes — a statement of what is necessary to ensure that claims about commitment to action actually come to fruition. O'Neill (2014, p.187) crucially highlights the potential for intelligent forms of accountability to allow the public to distinguish between trustworthy and untrustworthy institutions.

Translating the above analysis into conduct costs reporting we draw the subsequent observations. Within the institutional environment, we have the claim (i.e., trust has been eroded due to misconduct) and the commitment to action (i.e., a commitment to rebuilding trust).

7.1 The claim (i.e., trust has been eroded due to misconduct) and the dynamic institutional environment

As a preliminary consideration, we must seek to first briefly understand the origins behind the general breakdown of public trust in the UK banking sector. Jaffer et al. (2014b, p.32) state that until the early 1980s, the structure of the industry — whereby retail and commercial banks were managed as separate entities from investment banks — limited potential conflicts of interest and the dangers of moral hazard. Then the financial system changed in response to the changing institutional environment, as the case of deregulation moved higher in the political agenda. In particular the "Big Bang" on the Stock Exchange in 1986 — a hallmark of the Thatcher era — resulted in industry consolidation and the creation of "universal banks" (Jaffer et al., 2014b, p.54). These universal banks thrived on a new business model that commoditised mortgage and pension services, and created different avenues for misconduct: "excessive risk taking, extraction of rents, mispricing of risk, and more general conflicts of interest" (Jaffer et al., 2014b, p.61). Unsurprisingly, this business model and resultant misconduct eroded the trustworthiness in banks. (Jaffer et al., 2014b, p.33). And so began the *claim* (or at least, its rise in prominence).

In the period up to the financial crisis, the light-touch regulatory orthodoxy of the UK government influenced regulatory interactions and understandings as regards to the appropriateness of regulatory demands (Baldwin et al., 2011, p.287). The advent of the crisis saw public trust in banks rapidly erode, where the preference for deregulation and a light-touch philosophy suddenly gave way to more interventionist and rigorous forms of regulation in financial markets (Baldwin et al., 2011, p.1). However, July last year saw media reports on a swinging back of the pendulum towards a light-touch regulatory orthodoxy (Fortado and Arnold, 2015). Amongst the noteworthy institutional developments in the UK banking sector, since the onset of crisis, are:

I. The Libor scandal, which reinvigorated the public trust agenda and brought reputational risk to the fore (McCormick, 2015a, p.110-111).
II. The formation of the Parliamentary Commission on Banking Standards, in the wake of the LIBOR scandal, to investigate professional standards and culture (Parliamentary Commission on Banking Standards, 2013c).
III. A change in structure of financial regulation, from April 2013, which replaced the former tripartite approach under which the HM Treasury, BoE and Financial Services Authority ('FSA') shared responsibility (HM Treasury, 2011, p.4). Under the new structure, the FSA no longer exists and is replaced by three successor bodies: the BoE's Financial Policy Committee, the Prudential Regulation Authority and the FCA (HM Treasury, 2011, p.4).
IV. The formation of the Banking Standards Board in April 2015, which is an independent body tasked with raising standards of behaviour (Banking Standards Board, 2015).
V. The Senior Managers Regime, which came into force on 7 March 2016, to strengthen individual accountability (Prudential Regulation Authority, 2016).

Notwithstanding these developments, in the UK and elsewhere, public trust in financial services as whole remains at low levels. A 2016 global survey ranked the financial services industry sector last in a group of eight different industry sectors and revealed a score of 51% for public trust (based on a nine-point scale); in which over 33,000 respondents were asked if they trusted businesses in the industry to do "what is right" (Edelman, 2016, p.26).

7.2 The commitment to action (i.e., a commitment to rebuilding trust)

Policy-makers, regulators and bankers alike have called for a commitment to rebuilding trust. Lambert (2014, p.5) has lamented that there is no doubt of the general proposition that the UK banking sector has lost the trust of the public, and must gain it back. In its July 2015 Financial Stability Report, the BoE (2015a, p.27-28) further corroborated the significance of rebuilding trust and a social licence in light of misconduct:

> "Misconduct imposes costs on society at large and has undermined trust in banks and financial markets, reducing the effectiveness of the financial system ...To contribute fully to prosperity, banks and markets require a ‘social licence’ — the consent of society to operate and innovate. That requires fairness and accountability. An erosion of trust and loss of social licence risks the imposition of rules or restrictions on banks and markets that are detrimental to their contribution to prosperity."

Carney (2015a, p.4) more directly adds that the incidents of misconduct threaten systemic stability by posing indirect consequences — i.e., markets need a social licence, and the numerous incidents of misconduct have called that licence into question.

Banks have likewise made statements that they are committed to rebuilding trust given their misconduct issues. For the four major UK banks, a reading of the Chairman's statement in the 2014 Annual Reports and Accounts show an almost formulaic response:

> "Conduct issues have delayed the re-build of our capital and directly reduced shareholder value. They have also caused continuing reputational damage. I hope as we move beyond these issues we can fully rebuild the trust of our customers, and by doing so win more of their business" (RBS, 2015, p.7).

> "It is essential that we also rebuild trust. This is a major challenge for the UK financial services sector, not just because of the damage caused by the financial crisis but also because of the continuing legacy of past industry misconduct ...It is clear that regaining this trust, which is a business imperative rather than a ‘nice to have’, will take time" (Lloyds, 2015, p.6).

> "Restoration of trust in our industry remains a significant challenge as further misdeeds are uncovered but it is a challenge we must meet successfully" (HSBC Holdings plc, 2015, p.5).

> "Conduct issues have hurt Barclays – and the banking industry – causing loss of trust amongst stakeholders. Rebuilding trust is vital, enabling us to meet and exceed the growing needs of customers and clients" (Barclays PLC, 2015, p.5). (To be precise, this statement was in Barclay's 2014 Annual Report and Accounts, but not in the Chairman's statement).

7.3 Developing a pragmatic sustainability accounting tool: Linking the claim and commitment

The BoE was very clear that misconduct has damaged public trust and it appears that banks are in agreement with this view. Using O'Neill's proposition that accountability supports trust, we can add a correlation dynamic to amend the proposition: if misconduct is the very thing that undermines public trust then greater accountability on misconduct should help rebuild or support public trust (for banks who can demonstrate their trustworthiness). Accountability can naturally take many forms. But to recapitulate, the prevailing regulatory sentiment in the UK reinforces the view that banks should take it upon themselves to report conduct costs with greater clarity and can engage with others to achieve this. If we assume that the amended proposition is valid, then following O'Neill's analysis, we require a conception of the type of required action(s) and a statement of what is necessary to link the claim and commitment to action. Reducing conduct costs — as a strategic goal — can be conceived as the required action, and the CC Report as the statement which links the claim and commitment to action.

Schaltegger and Burritt (2010, p.382) state that pragmatic sustainability accounting tools should create a move beyond procedural, box ticking tasks towards eliciting behavioural changes within corporations. It could be argued that the transparent disclosure of total conduct costs in an annual report would expose a bank's *true* — not merely an estimated — level of misconduct tolerance to the glare of shareholders and wider stakeholders. In doing so, as the FEMR infers, banks feel competitive pressure to reduce their conduct costs, resulting in a 'race to the bottom' of sorts. Linking the claim and commitment to action, a CC Report can allow for a comparison of banks' conduct costs therefore creating a market for reputation, and allowing those with favourable comparisons to (re)build public trust. By virtue of this comparison, the report provides bridging mechanism for the public to distinguish between trustworthy and untrustworthy banks. The challenge for banks then is to embed desired behavioural changes that leads to higher standards of conduct (and, as a consequence, lower conduct costs). Given this, there is a need for banks to better understand both the 'beyond compliance' and risk management dimensions of their conduct — a matter returned to below.

From Power's perspective, league tables create pressure to operationalise disclosures into auditable performance indicators (Power, 2007, p.94). Having said that, how does the CC report compare with the current status quo of league tables that receive media coverage? With league tables, banks are able to engage in counter public relations nudges in the market for reputation — e.g., they could attribute the costs to legacy issues, as Lloyds does above, or they can simply say that the figures are overestimated with no corresponding explanation (Gluyas, 2015). As a trade-off, the CC Report helps remove such counter nudges in reputation as banks produce the results themselves, and may engage a wider audience. Indeed, the rationale behind the CC report is to stop banks claiming that they are committed to dealing with misconduct issues and rebuilding public trust, without actually doing so in practice.

Schaltegger and Burritt (2010, p.382) describe the twin track approach as one that takes heed of issues that could be of concern and the associated relevant indicators; whilst working towards strategic corporate goals within a setting where it is imperative to adapt to changing circumstances as they arise. Within this institutional setting, Schaltegger and Burritt (2010, p.382) declare that corporations need to engage in continuous assessment of their relevant sustainability issues and the measures which will assist. So are conduct costs, and their effect on banks' business models and financial stability, a relevant sustainability issue? This has been partly answered by the argument that repeated series of misconduct are said to pose systemic risks and place the sector's social licence in danger of revocation. However, to assess the validity of this argument we turn to stakeholder, legitimacy and reputational issues.

7.4 Legitimacy, stakeholders and reputational risk management

In the banking sector, conceptions of legitimacy have been wedded to the notion of public trust (Moran, 2013). As such, we view public trust as a barometer for legitimacy. Due to the similarities in theories relating to legitimacy, stakeholders and institutionalism, any attempts to treat them as discrete are misguided (Deegan, 2007, p.132-133). Lindblom (1994, p.2) describes legitimacy as a condition or status where an entity's value system is aligned with the value system of the larger social system in which the entity inhabits. Legitimacy is thus a relative concept; it is relative to the social system, and is time and place specific (Deegan, 2007, p.128).

Legitimacy theory posits that corporations continually seek to ensure that they operate in a manner consistent with the bounds and norms of public expectations (Brown and Deegan, 1998, p.22). In a dynamic setting, these bounds and norms can change over time thus requiring a corporation to be responsive. Premised on this theory, Brown and Deegan (1998, p.22) state that, as a theoretical construct, there is a "social contract" between the corporation and those affected by its operations. It is expected that the corporation complies with the terms of this contract that provides a licence to operate. A social licence is often spoken of as a constraint placed on corporations to meet public expectations and to avoid activities that the public, or influential factions like stakeholders within them, deem unacceptable (Gunningham et al., 2002, p.1). In fact, conditions of the institutional environment may impose more stringent demands on social licencers than those demanded by law and regulation, culminating in "beyond compliance" measures (Gunningham et al., 2002, p.1).

Legitimacy theory considers legitimation as the process which corporations undertake (e.g., through disclosure strategies) to reach the state of legitimacy (Brown and Deegan, 1998, p.23). Based on a number of academic papers in the 1980s and 1990s, there is evidence to suggest that corporate management does understand that it must uphold its social contract and, importantly, will react to changes in public expectations frequently in the "form of variations in the social disclosures made within the organisations' annual report" (Brown and Deegan, 1998, p.24-25). However, as Deegan (2007, p.145) draws to attention, there is a lack of research that illustrates that legitimising disclosures *actually* work in reducing legitimacy gaps.

Although banks may never achieve the status of (complete) legitimacy in a dynamic institutional setting, legitimation should be a process that is constantly pursued as they navigate through trust and reputational issues, ultimately, striving for long-run survival and sustainability (Deegan, 2007, p.128). Moran (2013, p.16) postulates that legitimacy problems in the UK have inspired an incoherent pattern of public disquiet, as typified in the short-lived Occupy protests. Moran (2013, p.30) conjectures that this incoherence explains why 'outrage effects' like those directed at executive bonuses in banking have not readily converted into a systematic basis for reform. However, as we have attempted to show: the CC Report is well-defined, coherent measure that dovetails with the current institutional environment.

Reputational risk management, as Power (2007, p.95) reflects, can serve as a catalyst for constructing legitimacy. Reputational risk, in a broad sense, is the risk that negative publicity regarding a corporation's business practices, whether true or not, will provoke a fall in the customer base, expensive litigation, or revenue reductions (Board of Governors of the Federal Reserve System, 1995). The European Banking Authority (2014, p.52) highlight that the increasing magnitude of conduct costs payments can lead to "substantial reputational damage". Data on the prevalence of reputational risk is sparse. However, a study by Karpoff et al. (2008) estimates that the reputational penalty — in terms of harm to future sales and funding costs — is 7.5 times the sum of all penalties imposed; based on 585 firms subject to enforcement actions relating to financial misrepresentations from 1978 to 2002.

Power (2007, p.93) articulates that reputational risk management is "morally ambivalent" and contains paradoxical elements. On the one hand, it symbolises the increasing centrality of ethics and values to corporate governance (Power, 2007, p.93). On the other hand, it represents the "instrumentalisation of stakeholder relationships", and the need to know and manage influential groups within the institutional environment (Power, 2007, p.93). Simply put, stakeholders are perceived to be sources of risk to business objectives (Power, 2007, p.93).

There may be numerous stakeholder groups — all espousing their own legitimacy claims with varying levels of influence — that operate within the institutional setting. This chimes well with a decentred understanding of regulation, where the government is not the sole locus of authority (Black, 2001). Management's core task is to decide which stakeholders should warrant and receive consideration in their decision-making process (Carroll, 1991, p.43). Incorporating reputational risk management into a corporation's decision-making can be likened to an 'intrinsic motivator' for actions: whether they are economic, legal, ethical or philanthropic. As a stakeholder group, the Foundation and its Project can be seen as part of a decentring effort to secure new markets for reputation in the banking sector. However, what is the Project's *influence* in amplifying issues that *warrants* the attention of banks? This is difficult to assess but the following facts can be put forth:

I. The Project was the first of its type, aimed at publishing conduct costs data in a consistent and comparable format.
II. In August 2014, the Project's work helped influenced the European Banking Authority to disclose for the first time the details of banks' losses as a result of fines and litigation when it published the outcomes of its EU-wide stress test (Foundation, 2014b, p.7).
III. Governor Carney (2014a, p.26) used the Project's data in a speech to convey the level of fines (related to fixed income, foreign exchange and commodities) imposed on a sample of ten banks by authorities in the United States, the United Kingdom and the wider European Union.
IV. As stated, the Project has received the regulatory endorsement of the FEMR, which includes the joint efforts of the Bank of England, HM Treasury and FCA.
V. The media has provided extensive coverage of the Project — e.g., BBC, Financial Times, The Guardian, The Wall Street Journal, Forbes, World Finance, New York Post, etc.

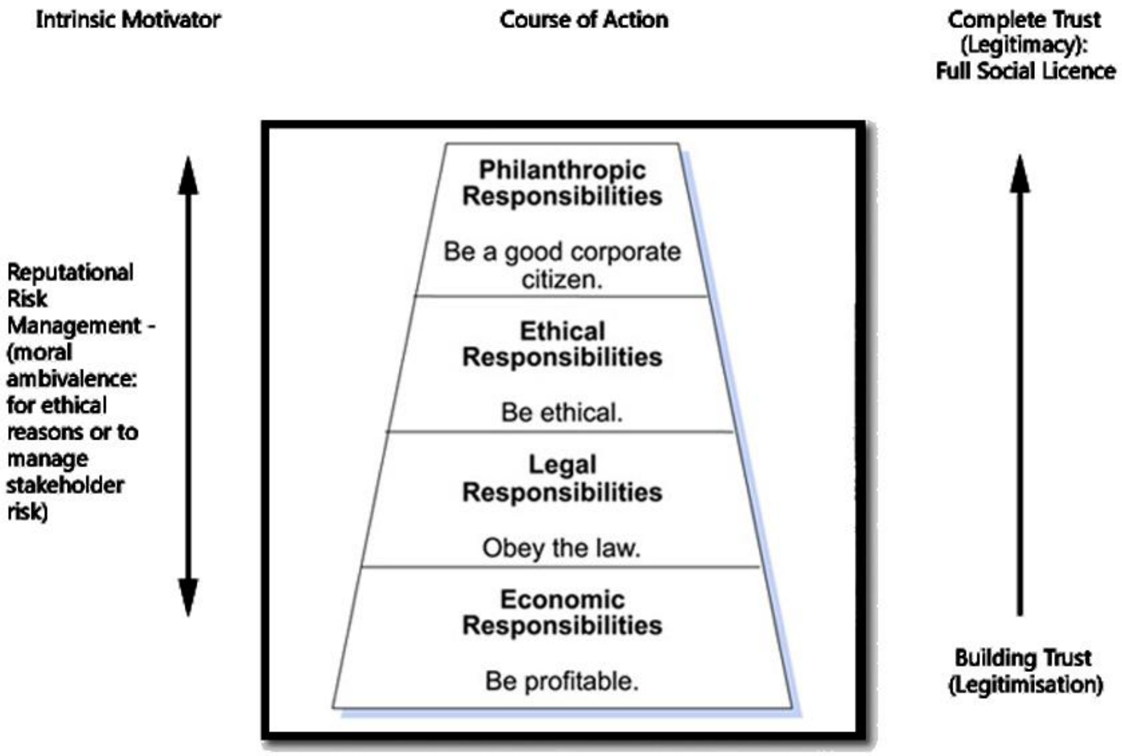
These facts engender the view that the Project carries a sufficient degree of influence to warrant attention. Power (2007, p.93) writes that so-called civil society organisations (in which we can include the Foundation) contribute to an increasing sense of corporate vulnerability and of demands to "listen to society". He proposes that within this type of institutional environment, corporate reporting emerges as an element of corporate reputational risk management, and legal compliance is not a driving factor (Power, 2007, p.93). The stakeholder driven approach, as described by

Schaltegger and Burritt earlier, provides a systematic narrative of what demands to listen to society by influential stakeholders can entail. The approach means that an understanding of sustainability performance is determined through stakeholder driven processes usually via three steps (Schaltegger and Burritt, 2010, p.382):

I. The first step involves multi-stakeholder dialogues to produce goals and result in jointly agreed measures. To a large extent, this was achieved with the FEMR endorsement.
II. In the second step, management is challenged to develop its sustainability accounting and measurement approaches. The CC report shows how management can meet this challenge.
III. In the third step, stakeholders are informed of the strength and direction of such engagement through two complementary processes — i.e., reporting (which provides a basis for greater stakeholder dialogue and incremental improvement) and verification (which adds credibility to the information disclosed). We are not yet at this step. Demands to listen to society may feature more significantly in the first two steps, but the third step also requires the conscious engagement of banks to report.

These steps reverberate with Power's sentiment (2007, p.95) that the enduring *ethical* challenge for corporate reporting is how to reflect and represent an openness and responsiveness as a basis for public trust. This view, as previously mentioned in Gold's writings, necessitates that building trust amounts to a conscious choice. Comingling ideas of reputational risk management and corporate social responsibility, we can construct a 'Legitimacy Pyramid' to visualise this ethical challenge as a reputational risk challenge.

7.5 The Legitimacy Pyramid: Reimagining Carroll's (1991, p.42) "Pyramid of Corporate Social Responsibility"



The conceptual underpinnings of the Legitimacy Pyramid are not designed to depict a perfect reflection of reality, but rather to provide a simple tool for analysis. At the top of the pyramid, where a status of complete trust and/or legitimacy is achieved, a full social licence is conferred as public expectations are completely satisfied. To re-emphasise, in a dynamic institutional environment, this status may never be achieved.

In the legitimacy pyramid, reputational risk management — as an intrinsic motivator — affects all levels of the pyramid. For sure, there are, evidently, many other risks that corporations can internalise into decision-making, e.g., political risk in an emerging market (Hopwood et al., 2010, p.13). At its core, the reputational risk management dimension seeks to promote the success of the corporation and its shareholders. By comparison, the trust and/or legitimacy dimension of the pyramid aims to reconcile reputational risk management with public expectations and a social licence. Taken together, these dimensions seek to promote a 'win-win' outcome between shareholders and wider stakeholders, as envisaged in an enlightened shareholder value approach (Kershaw, 2009, p.378). In this light, reputational risk management can be conceived as 'business case' for constructing trust and/or legitimacy. It is acknowledged that such a win-win business case, seen by some in the corporate social responsibility sphere as the 'holy grail', will have clear limits and can still facilitate the "unsustainability of business" (Unerman, 2007, p.90).

At the economic responsibilities level, excessive risk-taking and an uninhibited pursuit of profits may impose negative externalities on society and erode trust. *A priori*, a solitary focus on profits and the ability to satisfy public expectations are not natural bed-fellows.

For the legal responsibilities level, the discussion is framed by risk-based regulation ('RBR'). Black and Baldwin (2010, p.182) contend that post the Hampton Review of 2005 the UK has fully adopted RBR; no less than to the point of exhortation. The FCA (2013b, p.18) as a conduct regulator for banks is clear in its status as a risk-based regulator: "Our approach is risk-based and proportionate, recognising the diversity of regulated firms".

The FCA (2013b, p.3) has an overall strategic objective to ensure markets function well and to support this it has three operational objectives: protecting consumers, enhancing market integrity and promoting effective competition.

The FCA will evaluate risks with reference to achieving its objectives, whereas banks may treat these objectives as an internal risk management exercise that impact on profits and market share at the economic level (Baldwin et al, p.289-290). In this way, compliance transforms into a matter of risk management and non-compliance becomes a viable option (Black, 2008, p.454). Black (2008, p.454) adds that corporations should assess what level of non-compliance they are prepared to risk, and what the estimated cost of enforcement action and reputational damage may be of (detected!) non-compliance. By factoring in reputational risk, through carrying out risk/costs trade-offs, RBR arguably blurs the divide between the economic and legal responsibilities levels. The upshot of this is that when legal responsibilities do not meet public expectations (i.e., non-compliance become detected), the logic of RBR will likely undercut the restore public trust agenda.

Engaging with (influential) stakeholders at the ethical and philanthropic responsibilities levels may provide an opportunity for differentiation in terms of trust and also yield increases in shareholder wealth emanating from corporate citizenship: as banks compete in markets for reputation. The reputational risk conundrum for banks is establishing which stakeholders to engage with and to what extent. Carney (2014b, p.5) has warned that banks must realise that only "exemplary behaviour" would confer a social licence to a global financial capitalism. Even though the legitimacy pyramid tentatively illustrates that it is only at the ethical and philanthropic levels that banks can hope to fully — or almost fully — reconcile reputational risk with a social licence, banks arguably *do not* need to achieve full reconciliation. After all, they have shown resilience to facing trust issues for many decades. It is as this point that it may seem appropriate to engage in a bit of speculation: What would be the effect in a legitimacy and/or trust context of a CC Report? It could be speculated that it will rebuild public trust that has been undermined specifically by misconduct and mitigate the perceived legitimacy gap. Such speculation is, however, moot as rebuilding public trust (and producing a CC Report) requires a conscious choice by banks. Or as Power puts it: an openness and responsiveness.

A balanced view, perhaps, is that a new form of accountability has been constructed, to support the restore public trust agenda: providing credence to its relevance within the institutional environment. The pragmatic sustainability accounting tool is there; banks must now decide how to react. Opt for openness and responsiveness or embrace a 'business as usual' approach? One thing seems clear, though: a reorientation of accounting disclosures that places emphasis on conduct performance may mark a step towards a sustainable banking sector. This is no peripheral issue, but at the same time is not a complete solution in itself, as Buhr (2007, p.67) upholds:

> "[Sustainability] reporting will not save the planet [nor preserve the sustainability of the banking sector]. Accountability is a two-way street that involves not only the giving of account but also the receiving of accounts. Accountability requires the engagement of a civil society that seeks to change, thoughtfully and democratically, the way we exist within our social eco-system. It is this engagement that propels social change."

8.0 Conclusion

For real markets to maintain their social licence, it is crucial that private market participants (including banks and stakeholders) and public authorities collectively act to countervail the overshadowing of an ethical malaise and lapses in banking standards. *Vis-à-vis* misconduct issues, we have attempted to show how sustainability accounting can contribute to the ability of real markets — in particular, banks — to maintain their social licence by (re)building public trust. Schaltegger and Burritt provided an ambitious challenge: to develop a well-defined approach to sustainability reporting and accounting, and use this to inspire behavioural changes within corporations. By analysing conduct costs and its reporting trade-offs, as a pragmatic sustainability accounting tool, we conclude with the following observations.

Firstly, although the term conduct costs sometimes evokes confusion, the FEMR endorsement of an industry-wide definition, offers the promise of a shared understanding of conduct costs. Secondly, the league tables' figures as estimates have limitations but they denote an evolutionary step in sustainability accounting; a step in which systemic risks are already revealed. Thirdly, we discussed how conduct costs are not reported in a clear or comparable manner by banks and thus analysed the proposal of a CC Report to ameliorate this shortcoming. Fourthly, by appraising how the CC Report can prove responsive to the restore public trust agenda, we see the cogency of this report to provide a connecting factor to the institutional claim (i.e., trust has been eroded due to misconduct) and the commitment to action (i.e., a commitment to rebuilding trust).

It is clear from the foregoing that such a disclosure reform must be tempered with reasonable expectations. The trade-offs in conduct costs reporting are weighted in favour of the production of CC Reports. However, viewed through the lens of reputational risk management and its interplay in the legitimacy pyramid, the production of such a report, ultimately, requires an openness and responsiveness by banks to commit to rebuilding public trust. Macve (1997, p.194) once wrote: "Change what you count and you change what counts". Watch this space.

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