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DNB's Regulatory Journey: How Regulators Left a Norwegian Bank Out in the Cold

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Abstract

Anti-Money Laundering (AML) is an important societal and industry issue that demands great attention from financial institutions and regulators. This Thesis describes the situation of a market-leading Norwegian bank, DNB, and its challenges with achieving AML compliance. This Thesis aims to analyse DNB's compliance challenges in the period after the 2018 AML Act to March 2024.

The Case portrays a situation of prolonged non-compliance and regulatory scrutiny for DNB. It showcases DNB's shortcomings with compliance and its struggles with meeting regulators' expectations. It describes DNB's efforts to restore reputational damages and to achieve compliance. It also draws on lessons from a competitor, Danske Bank, that faced similar regulatory challenges.

The Literature Review introduces relevant topics applicable to the Case. It focuses on governance mechanisms, post-crisis communication strategies, and the role of agency conflicts in financial institutions. The Teaching Note describes how the Case can be used in a class-setting. It gives an analytical perspective to the challenges faced by DNB, provides alternative recommendations, and gives an overview on the situation.

This Thesis contributes to the understanding of compliance and regulations in financial institutions. It actualizes the consequences of non-compliance and firm efforts to achieve compliance. It demonstrates the importance of prioritizing compliance efforts, balancing different stakeholder interests, and discusses strategies for restorative reputation management.

Keywords: Anti-Money Laundering (AML), Compliance, DNB, Danske Bank, Norway, Agency Conflicts, Corporate Governance, Reputation Management.

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Resumo

O combate ao branqueamento de capitais (AML) é crucial para a sociedade e para o setor financeiro, exigindo atenção das instituições financeiras e das entidades reguladoras. Esta tese analisa os desafios de conformidade do DNB, um banco norueguês líder de mercado, desde a implementação da Lei AML de 2018 até março de 2024.

O caso do DNB retrata um período de incumprimento prolongado e controle regulatório rigoroso, destacando as suas deficiências em conformidade e as dificuldades para atender às expectativas dos reguladores. A tese descreve os esforços do DNB para recuperar os danos reputacionais e alcançar a conformidade, além de basear-se nas lições do Danske Bank, que enfrentou desafios regulatórios semelhantes.

A revisão da literatura aborda teorias relevantes, incluindo mecanismos de governação, estratégias de comunicação pós-crise e o papel dos conflitos de agência nas instituições financeiras. A Nota de Ensino apresenta como o caso pode ser utilizado em sala de aula, oferecendo uma análise dos desafios enfrentados pelo DNB, recomendações alternativas e uma visão sobre a situação.

Esta tese contribui para a compreensão da conformidade e da regulamentação nas instituições financeiras, atualizando as consequências do incumprimento e os esforços da empresa para alcançar o cumprimento. Demonstra a importância de priorizar os esforços de conformidade, equilibrando os interesses das partes interessadas, e discute estratégias para a gestão restauradora da reputação.

Palavras-chave: O combate ao branqueamento de capitais (AML), Conformidade, DNB, Danske Bank, Noruega, Conflitos de Agência, Governação Empresarial, Gestão da Reputação.

Título: O percurso regulamentar do DNB: Como os reguladores deixaram um banco norueguês gelado

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Preface

This master Thesis marks the end of a two-year long study in International Management at Católica Lisbon School of Business & Economics. Writing this Thesis has been an interesting exploration of AML compliance in the financial services industry. Anti-Money Laundering is an important societal issue, and there has been little research on the subject to date. The choice of this topic came from a personal curiosity and an ambition to write a business case about a more unknown topic in a management setting. By concluding this Thesis, I feel satisfied that I have now fulfilled this ambition.

I want to express my appreciation to the generous employee at DNB who shared his insights and views about this situation. His insights helped provide the necessary grounds for this Thesis. A special thanks goes to my supervisor, Nuno Magalhães Guedes. His valuable feedback, insights and perspectives helped steer this work in the right direction. Thank you to friends and family who have helped encourage and support me throughout my studies and this Thesis.

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1. Case Study

In March 2024, after having endured more than two years of governmental pressure, the Norwegian bank DNB started analysing different strategies to end its duress. This strategic task was prompted after the exit of one of its competitors, Danske Bank, from Norwegian markets.

DNB made front page news for all the wrong reasons in 2021. In addition to receiving poor customer satisfaction ratings that year, the bank was also hit with a devastating fine amounting to NOK 400 million. By September 2022, DNB's problems grew larger. The bank faced daily fines due to large amounts of insufficient or missing customer IDs. These fines drained them of NOK 1.5 million each month with no clear end date in sight.

DNB was originally founded in 1822 as Den Norske Bank. The bank grew to be one of the largest financial services groups in the Nordic Region. With two million personal customers and 228 000 corporate clients, it became Norway's largest financial services group. By 2023 their yearly turnover amounted to NOK 81.7 billion¹.

A similar pressure was experienced by Danske Bank in 2020. This bank was also penalised with daily fines due to poor collection and storage of customer information. Danske Bank announced its intention to sell off all services related to personal customers in the Norwegian market in 2023.

Was Danske Bank's exit a strategic move DNB could have considered? What was the source of DNB's slow reaction? Could DNB have implemented any strategic initiatives to avoid this dire situation?

1.1.1. The Financial Supervisory Authority of Norway (Finanstilsynet)

Norway's economy was steadily growing since 1969, when rich natural resources such as petroleum, oil and gas were discovered. While high economic growth through extraction and export of these resources was enriching for the country, a coinciding focus on strict and progressive regulation also grew. This focus was vital to secure sustainable shared economic growth for Norwegian citizens, ensuring that profits from the country's natural resources did not end up in the hands of the few.

The country's historic regulatory efforts had since gotten more sophisticated. In various indexes of economic freedom, Norway had a high performance in recent decades. An important factor

¹ Converted to EUR on May 30th 2024: 7.155 billion EUR.

these rankings were measured by was regulatory efficiency. Regulatory efficiency indicated to what extent the country passed necessary regulations and laws and to what extent these were followed. It also measured industry compliancy with laws and regulations. On an international level, Norway also had a relatively low risk of anti-money laundering and terror financing compared to the rest of Europe. (See Exhibit 1).

Monitoring and assessment of financial security in Norway had been done by the Financial Supervisory Authority of Norway (Finanstilsynet) since its establishment in 1986. Finanstilsynet focused on promoting financial stability in Norway. It was an independent governmental body that was built on laws and decisions passed in the Norwegian parliament. As well as acting on laws passed by parliament, EU laws and regulation were also implemented due to the EEA agreement between Norway and the European Union.

1.1.2. The Anti-Money Laundering Act

In 2018, the Anti-Money Laundering Act (AML Act) was passed and ratified in Norway. The purpose of this law was a new approach to prevent and uncover anti-money laundering and terror financing within the country. The law put importance on efforts to protect the financial system in Norway. It was also used as a safety measure, to ensure that all reporting entities, especially in banking and insurance, were not used as part of activities related to money-laundering and terror financing.

The law introduced several new changes to previous financial legislation. It sought to close the distance to the European Union's financial legislation. The law was also a change to a risk-based approach. However, the new law largely influenced an increased due diligence focus targeted towards customers. The mandate to give out larger penalties in cases of non-compliance was also increased. This meant that financial institutions were expected to collect, store, and continuously monitor and analyse extensive information about personal and corporate clients. This also included ultimate beneficiaries, meaning owners who ultimately profit from corporate activities. Banks and insurance companies were, in other words, ordered to improve their knowledge about their customers. From this approach stemmed the term Know Your Customer (KYC). All European banks were expected to implement KYC processes for new and current customers.

In practical terms, the new law meant that Norwegian financial institutions were ordered to increase collection and monitoring of both customer activity and customer identification. It was also necessary to increase knowledge about customers' intended use and activity of bank

products, as well as obtaining knowledge of customers' origin of means. The Anti-Money Laundering Act of 2018 established a strengthened and robust framework all financial institutions were obligated to follow.

1.2. DNB

Since its founding in the Norwegian capital Oslo in 1822, DNB had grown to be Norway's largest bank. The bank was formed through a merger of two banks and had, in its rich history, fought off many competitors to get to its market leading position. DNB grew to its position mainly through a series of mergers and acquisitions, with its most recent acquisition of another bank made in 2021. DNB was also partly owned by the Norwegian state, which owned 34% of all DNB shares on the Norwegian stock exchange. (See Exhibits 2, 3, and 4).

The bank had experienced financial success from a high demand for capital from its customers. As the banking industry delivered a relatively homogenous product, DNB also had a high focus on innovation. It was leading in developing its online banking which in 2023 had the most users in Norway. Through various PR strategies and marketing campaigns, the corporate brand had also become a staple amongst Norwegian citizens.

1.2.1. DNBs prior Anti-Money Laundering Work

Bjørn Knutsen² arrived at DNB in 2018 and was hired as head of the anti-money laundering department. He started his career in the Norwegian police department, where he specialized in financial and environmental crime and investigations. After 12 years in the police department, he went to the National Authority for Investigation and Prosecution of Economic and Environmental Crime (Økokrim) where he spent 11 years. With a two-decade long track record of financial crime investigations under his belt, DNB was the next step in his career. Anti-money laundering was no new subject to Bjørn, who brought with him extensive experience into the organisation. He was an expert in the field. At the time, anti-money laundering was a relatively unknown topic among non-specialists. He described the situation at DNB in 2018 as the following:

“(...) as a new employee at DNB, I felt there was a lot of focus on AML even when I was hired, but implementing uniform routines, a common risk-based understanding, indications of money laundering and especially what it means to update customers is and will be a continuous process (...)”

² Name changed to protect anonymity

He further described DNB as being a large-cap bank. With its large size also came a high employee turnover in the organisation. That meant there was a continuous focus on ongoing training and onboarding of new employees. In addition, there was a focus on continuous updates to internal rules and routines within the bank.

Despite its impressive size and market-leading position, DNB had experienced a negative trend in consumer preferences. DNB was rated poorly in consumer bank preferences in comparison with other smaller banks, ranking below the industry average. (See Exhibit 5).

After having spent roughly a year at DNB, Bjørn noticed a shift happening as anti-money laundering efforts were becoming more important within the organisation. The topic started gaining more traction and importance and started becoming a common focus of discussion between departments. Both higher-ups at DNB and the public started learning about what anti-money laundering entailed. Previously, anti-money laundering had been an issue dealt with and merely discussed by those in the know-how in the organisation. It was a topic spoken usually between investigators and specialists and it mostly stayed within compliance departments. The following year, Bjørn was put in charge of a newly created division at DNB, called Group AML. This was created to integrate the different departments working with AML and sanctions within the organisation. It was created in 2019, in a time with much focus on sanctions in Europe due to global tensions and conflicts.

Anti-money laundering becoming more important was not only a trend confined to DNB. Regulatory bodies and the public became increasingly aware of the subject area as well. With greater public awareness came an increased set of expectations regarding compliance within financial institutions. Norwegian banks and insurance companies were put under more scrutiny as to how resilient they were to withstand and fight off potential attempts at money laundering. Public and regulatory awareness, including the legislative passing of the Anti-Money Laundering Act of 2018, amplified the pressure put on DNB and the relevance of anti-money laundering efforts. The same trend was also seen by Bjørn, as he described the situation:

“(…) in 2019 and onwards, there was a noticeable shift to increased focus on AML also from the C-suite at DNB. They imposed stricter requirements for implementation and increased reporting on progress upwards in the system (…)”

By 2019, upper management at DNB started acknowledging the pressure stemming from these new regulations. The bank imposed a greater emphasis on reporting protocols within the bank. The increased public awareness was also an important factor for why this topic needed to be

taken more seriously. Upper management also emphasized new internal expectations to the AML work. They expected more transparent reporting upwards in the organisational hierarchy. A greater focus was also put on due diligence in other departments to reduce discrepancies and faulty work. It was a shift felt throughout DNB, regardless of departmental entity.

With anti-money laundering becoming more noticeable and prioritized by upper management at DNB, necessary resources were also given out to increase productivity. Departmental budget and headcount increased and new protocols were put in place. Reporting standards were also polished and adjusted. Work and progress in anti-money laundering was made to be more transparent between the organisation's hierarchical levels. Upper management received frequent reports on progress and status. DNB also started making public reports on threats and trends to showcase the importance the organisation put on compliance. It seemed like regulatory efforts, spearheaded by the Anti-Money Laundering Act of 2018, had started to reap its results.

1.2.2. The First Fine

Fast forward two years, and DNB received grave news. From the outside looking in, it seemed like the organisation had things under control regarding compliance. However, external audits revealed the opposite. Despite the bank's renewed and sharpened focus on anti-money laundering work in 2019, regulatory standards were still not up to par. DNB was thus dealt a devastating hit in the form of a hefty fine of NOK 400 million³. Proportional to its annual revenue in 2021, this fine amounted to 0.7% of yearly revenue at DNB. The magnitude of the fine was felt throughout the organisation. Finanstilsynet published the fine in a report with the following description:

“In February 2020, Finanstilsynet carried out an AML/CFT⁴ inspection at DNB Bank ASA. The purpose of the inspection was to follow up previous AML-related inspections. The inspection revealed serious breaches in the bank's compliance with the Anti-Money Laundering Act. (...) On the basis of offences uncovered under the current Anti-Money Laundering Act, Finanstilsynet has imposed an administrative fine of NOK 400 million on DNB Bank ASA.”

The fine came with high reputational costs. Naturally, this was devastating news to DNB. It served as a harsh reality check for the bank. The bank had already escalated its anti-money laundering work from 2019, through the introduction of new protocols and more involvement

³ Estimated conversion to EUR on May 28th 2024: 35.050 million EUR

⁴ CFT: Combating the Financing of Terrorism

from upper management. However, these initiatives were still deemed insufficient. With its position in the Norwegian market, it was safe to say that regulators were keen on setting an example for other banks regarding standards of compliance and compliance with the law itself. DNB thus seemed like an appealing target for regulators. The fine and its size set an example for how grave the situation was seen by the Norwegian state. In a press release published in May 2021, DNB responded with a claim against the decision:

“In the past few years, DNB has implemented several measures to strengthen its anti-money laundering efforts. Organisation, risk assessment, risk classification and electronic monitoring are areas that have been significantly strengthened. The Board and Group Management regularly follow up this important work. DNB does not recognize Finanstilsynet's assessment that the Board and management failed to prioritise anti-money laundering.”

The fine did damage to DNB. It represented a clear message to the organisation that their work was subpar. Something needed to change. Processes were yet again renewed to improve the organisation's work. Prioritization of the issue also massively escalated. From Bjørn's perspective, the fine was a trigger factor. It hurt its image, its reputation, and was a blow to the bank's budget. Prioritization of anti-money laundering was therefore yet again increased at DNB. Bjørn described the situation in the following way:

“(...) what accelerated the AML work to a greater extent was the "fee" of NOK 400 million as well as the supervision from Finanstilsynet in 2020. This was seen in the context of previous audits where Finanstilsynet stated that progress on AML work was not fast enough (...)”

1.2.3. Introduction of Daily Fines

After having paid out and dealt with the immediate repercussions stemming from the fine in 2021, DNB hoped for a brighter future ahead. The NOK 400 million fine had done damage to the image and reputation of the organisation. It was time to rebuild its position as a safe and compliant bank in Norway. Up until this point, DNB had already escalated its work related to anti-money laundering. After the fine however, more resources were pushed to the right departments. Budgets were increased, and talented new employees were hired to increase manpower. This was reflected in the eyes of Bjørn Knutsen:

“DNB has hired several highly qualified employees in the areas of AML/Fraud in recent years. DNB is one of the very best banks in Europe at detecting and preventing fraud and sanctions.”

Bjørn and DNB were starting to feel more confident after its fine in 2021. Although the fine felt like a setback to the work they had put in, there was a growing confidence in the organisation’s ability to handle compliancy and regulatory pressure moving forward. However, Norwegian regulators yet again felt different. In late 2022, Finanstilsynet published the following decision on DNBs progress in anti-money laundering: *“Finanstilsynet has decided to impose a coercive fine on DNB as they have not complied with the rectification order by the deadline.”*

This decision came after two rounds of status reports made by Finanstilsynet on DNB. The first report was published August 1st, 2022. This report stated that DNB had a too high backlog of customer IDs that had not been collected and stored. From the report, DNB was yet to collect IDs on 208 881 personal customers (8.1% of their customers), and 29 618 corporate clients (11.6 % of their customers). DNB was also missing numerous IDs on ultimate beneficiaries connected to various bank accounts. 25 days later, on August 26th, a second status report was published. DNB’s backlog had now decreased. In this report, DNB was now yet to collect customer IDs on 159 423 personal customers (6.2% of their customers), and 15 458 corporate clients (6.1% of their customers). The coercive fine entailed a NOK 50 000 penalty per business day. The first fine was set to start September 2nd, 2022. The fine would only stop occurring when Finanstilsynet deemed DNBs progress and work “satisfactory fulfilled.”

Although DNB had made a direct response to Finanstilsynet, the backlog of missing IDs was still too high in Finanstilsynet’s view on standards. DNB had, in August 2022, put pressure on its customers to obtain missing IDs. However, this was nowhere near the sought-after standards that Finanstilsynet had put forth. DNB reasoned that the holdup stemmed from red tape processes and slow bureaucracy from the police. Customers without valid passports or IDs needed to renew their documents at the police station. This was a process that took time, and a process outside of DNBs control and jurisdiction. Another problem arose because a high number of customers were of old age. This made them difficult to reach. Other customers were not reachable through standard channels like phone, email, or online banking. Such customers would be reached through postal mail. This process took significantly longer time. There were also other cases that took time. Newly deceased customers, customers under guardianship, and bankruptcy estates to name a few.

Despite DNBs efforts to make legal claims against this decision, the daily fines were still set in motion. After having dealt with the financial burden of NOK 400 million, DNB was now faced with a new headache in the form of daily fines. These troubles added to the bank's frustrations. Although the bank had put in new and stricter protocols for dealing with anti-money laundering in 2021, including more involvement from upper management, their efforts still came up too short. However, despite the external pressure these fines represented, Bjørn saw the situation in a different light:

“As I understood it, the daily fines had little impact on the AML work and progress in DNB. At this point in time there was a very strong focus on AML and not least the re-identification of customers (...)”

1.2.4. What Actions Were Taken?

The coercive fines would only stop when Finanstilsynet saw satisfactory fulfilment of DNBs anti-money laundering work. This vagueness left the bank with no feeling of security or concrete understanding when the fines would end. No clear standards of fulfilment for what was deemed satisfactory by regulators meant the fines had an unclear end date. Which initiatives or new processes were most viable to reach satisfactory levels was unclear to the board. In Bjørn's eyes, most of the customers without collected IDs by the time the coercive fine was given had by now been processed and finished. Of the remaining customers, Bjørn had the following to say:

“(...) passive customers who did not respond, old people who were unable to send in ID through online banking, bankruptcy estates, estates of deceased people, etc. (...) Finanstilsynet had little understanding that this takes time.”

The organisation saw it best to continue its current processes. As Bjørn had stated, the bank had by now put in place strict internal requirements for handling anti-money laundering. It had time and time again polished and adjusted its processes. Internal protocols had been updated and renewed, and transparency between departments and reporting to upper management had been escalated. It seemed there was little that could be done to improve and reduce the duration of the coercive fine.

DNB had also suffered reputational damage during the last years due to the fine and the continuing coercive fines. The brand image had taken a beating. The previous portrayal of a secure and solid bank that seemed to withstand anything that entered its path was now suffering under the hands of regulators. It had faced scrutiny and was now paying its dues. DNB needed

to take action to rebuild its reputation as a safe, compliant, and secure bank. There seemed to be two new challenges ahead. Firstly, the bank needed to rebuild its relationship with regulators. There seemed to be a shortage of goodwill between DNB and Finanstilsynet – this needed to change. Secondly, and most important, DNB needed to rebuild its relationship with its customers and its public image. News and constant headlines of a non-compliant bank was tarnishing its reputation and trust.

The solution to these challenges seemed to be a greater focus on transparency. DNB had already started publishing reports on trends and threats. These reports were published on a yearly basis. This became an important area for the bank to showcase its work in anti-money laundering to regulators and the public. Bjørn pointed out this work, as well as having public workshops about its compliance work, as a success factor.

1.2.5. Lessons Learned

After having endured several years of regulatory pressure and scrutiny, the bank was looking forward. DNB was still a market-leading bank and the largest bank in Norway. On what the future would hold, Bjørn described the following:

“Besides continuously staying updated on current trends and threats, new technology and systems, and continuous training and calibration, I think DNB is where it needs to be in regards to focus on the current AML work.”

On his expectations from politicians and regulators, Bjørn thought the following:

“What I expect from Finanstilsynet is a clear set of expectations regarding prioritization of focus areas within AML. The way the AML work is rigged today is towards an expectation of full monitoring of all transactions with possible indication of something illegal going on. There is too low of a threshold for what must be investigated and filed, and this creates fearmongering amongst all reporting financial entities. Økokrim received around 23.000 reports of cases with suspected illegal activity in 2023, of which a lot of these are unnecessary and out of their reach to process.”

1.3. Danske Bank

Danske Bank was founded in 1871 in the capital city Copenhagen, Denmark. Originally founded under the name Landmarksbank, the bank sought to provide a more inclusive banking experience to its customers. At the time of founding, farmers were not able to borrow money from banks, and had to seek financial funding from private investors instead. Borrowing money

through private financiers meant more hassle, a higher risk and higher interest rates than from institutions. Landmarksbank, which later changed names to Danske Bank, sought to provide a solution to this problem. The bank acquired an initial capital that was significantly higher than most of its competition, and thus started its rampant company growth. Many new branches were opened and the bank scaled quickly. From its agricultural and inclusive roots, Danske Bank quickly became Denmark's market-leading and largest bank.

In 2023, Danske Bank had an annual turnover of DKK 52.4 billion⁵. The bank offered traditional banking services to both its personal and corporate clients. With branches in eight different countries, the bank had international outreach. Danske Bank was not only seen as a success domestically, but also internationally. The bank held a firm position amongst customers in the Nordics. It was ranked as the third largest bank in Norway and Finland in 2023, fifth in Sweden, and it also offered a range of banking services in the UK.

1.3.1. Danske Bank: Introduction of Fines

Despite its success in the Nordics, Danske Bank met regulatory hardship in Norway. After an external audit from Finanstilsynet in 2020, several breaches of the Anti-Money Laundering Act were uncovered. The report found that Danske Bank had shortages in KYC for personal customers. The report focused specifically on Danske Bank's lack of collection and storage of customers that were regarded as Politically Exposed Persons (PEP). PEP included individuals that held political positions, and relatives of people with political power. These types of customers were prone to a higher risk of money laundering, corruption, and bribery due to their political influence and access to public funds.

After the report that Finanstilsynet published, Danske Bank was given a deadline of two months to make corrections and to strengthen its knowledge about customers regarded as PEP. After the deadline was passed, Finanstilsynet saw little to no improvements from the bank. Danske Bank was therefore given a coercive fine of NOK 10 000⁶ per day.

From November 7th, 2022, regulators increased the pressure put on Danske Bank. Improvements were not made fast enough, and Finanstilsynet tightened its grip on the bank to speed up progress. The coercive fine was increased to NOK 50 000⁷ each business day. This was done to put increased pressure on the bank to incentivize its progress of work. Another

⁵ Estimated conversion to NOK on May 28th 2024: 80.1 billion NOK, or 7.023 billion EUR.

⁶ Estimated conversion to EUR on May 30th 2024: 876 EUR.

⁷ Estimated conversion to EUR on May 30th 2024: 4 380 EUR.

reason why the coercive fine was increased was because Danske Bank had by then paid this fine for two years continuously with no clear developments in sight. Finanstilsynet also stated they had received several assurances from the bank that progress was made. However, no documentation proving the fact was delivered from the bank.

1.3.2. Danske Bank's Solution

After having spent several years enduring daily fines due to the mishandling of the Anti-Money Laundering Act, Danske Bank had to consider its options. It seemed that any attempts at ending the fines were futile. The regulators stood their ground. Danske Bank was in a tough spot and had to figure out a way to end the costly fines.

Therefore, on June 7th 2023, Danske Bank announced its intention to exit the Norwegian market for personal customers. The bank would sell off its business to one of its competitors, Nordea. The bank would continue its core operations in the Norwegian market, but all business regarding personal customers would be sold off. The sale was approved December 15th, 2023.

Danske Bank's exit served as a cautionary tale. The coercive fines were a wake-up call, and prompted a stronger prioritization on compliance with the Anti-Money Laundering Act. The strict regulation and requirements showcased a tough stance on regulatory compliance. The story of Danske Bank and its exit could be seen as a warning to other banks such as DNB. Bjørn Knutsen was now wondering what lesson could be learned from the competitor's decision and what else DNB could do.

2. Literature Review

The following literature review aims to provide an assessment of a selected choice of topics, relevant for the Case. It also seeks to provide theoretical frameworks relevant for application in the Teaching Note.

In the following sections, three main topics of literature will be approached and discussed. Firstly, concepts surrounding the field of *agency theory* will be addressed. This topic has been limited to a critical assessment of issues presented in this theory. However, applications on compliance issues have also been included to provide an immediate connection to the central theme of this thesis, that is compliance. Literature on *corporate governance* is subsequently assessed. This literature has been limited to give an account of useful mechanisms utilized by firms to reduce agency costs, as described in agency theory. The literature review is concluded by an assessment of concepts in the field of *crisis management*, with an emphasis put on crisis communication.

2.1. Agency Theory

Agency theory highlights the challenge of risk-sharing between cooperating parties. This means the relationship between a principal and an agent. The principal delegates the work or responsibility to the agent, who in turn performs the delegated work (Jensen & Meckling 1976; Eisenhardt 1989). This theory builds on the premise that corporate behaviour is focused to prioritize the financial markets (Weinstein, 2019). A central problem in agency theory is the potential for opportunism or prioritization of self-interest due to the differences between attitudes, behaviours, and risk-profiles from the two parties. The agent may act opportunistically and favour sub-optimization of goals by prioritizing self-interests rather than fulfilling the principal's goals, i.e. maximizing firm value (Eisenhardt, 1989). These differences and the risk of opportunism have been coined as agency costs (Jensen & Meckling, 1976).

2.1.1. Agency theory in financial institutions

Eisenhardt (1989) further introduced agency theory as an area of interest for the financial industry as it could be used to describe corporate decision-making. The perspective in this paper discussed the principal-agent relationship between the client and the bank, with the client acting as principal and the bank as its agent. The client entrusts capital and responsibility to the bank, and the bank ensures financial security for the capital (Naheem, 2020). This perspective assumes that the bank, in its role as agent, may act opportunistically and pursue self-interests for greater profits (Wright et al., 2001).

Agency theory represents an issue in the relationship between principal and agent. The relationship must be built on mutually beneficial grounds and cannot favour a singular side (Huang, 1995). While agents tend to be drawn towards prioritization of self-interests in pursuit of greater profits, clients seek financial security and return on capital. This potential conflict is solved when the bank generates profits in legal ways that are within the relational contract between the client and the bank. This ensures a mutually beneficial relationship (Wright et al., 2001; Eisenhardt, 1989; Naheem, 2020).

2.1.2. Agency theory in AML compliance

A new link between agency theory and anti-money laundering (AML) compliance in the banking sector was discussed in Pellegrina & Masciandaro (2008). The relationship between the bank and regulators was seen in a similar light to the principal-agent relationship between the client and the bank. Regulators were introduced as a second principal (Eisenhardt, 1989; Pellegrina & Masciandaro, 2008). This new perspective introduced an ever-complex principal-agent relationship as the bank would have to balance two interests instead of one: the client and the regulators (Pellegrina & Masciandaro, 2008; Naheem, 2020). Adding AML compliance to the traditional client-bank relationship meant adding a three-fold conflict of interests into the mix. The interests of regulators and the clients are conflicting, as clients may face lower return on capital due to higher costs from increased compliance bureaucracy demanded by regulators. The bank is forcibly tasked with pleasing its two principals' opposing interests, as well as its own (Naheem, 2020; Pellegrina and Masciandaro, 2008). (See LR Exhibit 1).

Pellegrina & Masciandaro (2008) viewed the relationship between AML regulations and AML compliance in a cost-benefit scenario. When regulatory costs overturned potential penalties from non-compliance, prioritization of compliance with regulation would lose its priority (Pellegrina & Masciandaro, 2008). This scenario presents a compliance limit in the financial industry, as the bank would prioritize its most cost-effective alternative in a situation where it possesses perfect information (Naheem, 2020). An extreme depiction of this scenario was described when UK banks closed personal accounts for Syrian students and citizens due to increased regulatory bureaucracy and associated costs (Bachelor, 2014; Naheem, 2020).

An isolated area of conflict between regulators and the bank is also described. While the issue of a mutually beneficial relationship between the client and the bank is solved through mutual profits in Wright et al. (2001), the same issue is not as easily solved between the bank and regulators. Regulators introduce AML regulations with the purpose of societal improvement

while banks inherently wish to pursue profit. This conflict of interest adds to the strained principal-agent relationship between the two (Pellegrina & Masciandaro, 2008; Naheem, 2020). The relationship introduces no or few benefits for the bank, but rather increased costs due to stricter compliance processes. It also introduces the threat of punishment in cases of non-compliance (Naheem, 2020). Another issue was found as several banks turned to over-reporting of suspicious cases related to money laundering, while the number of legitimate money laundering threats declined. Banks seemed to prioritize quantity over quality in AML compliance after the US PATRIOT ACT (Takáts, 2007). Other findings have found market withdrawals after the introduction of stricter AML regulation, especially for smaller financial services institutions (Perez, 2015). Compliance with AML regulations have also been found to increase the burden on organisations involved (Razavy and Haggerty, 2009).

2.2. Corporate Governance

Corporate governance as a field holds vast practical importance (Shleifer & Vishny, 1996). It is a central idea in organisational theory. It provides a framework for company engagement with externalities as well as guidelines for company code of conduct. Companies are involved with external forces such as laws and regulations, shareholder expectations, and public opinion. This creates a system of rules and processes companies are guided by (Cadbury, 2000). The ultimate purpose of corporate governance is the achievement of long-term sustainable success. This is achieved through operational goals, which involve key characteristics like efficiency, transparency, and accountability. These characteristics make up the principles for corporate governance (Clarke, 2003). Agency theory has been foundational in corporate governance, and presents various implementable governance mechanisms (Panda & Leepsa, 2017).

A core challenge in corporate governance is the risk business owners take on when supplying financial resources to companies. Several mechanisms in corporate governance are therefore utilized to reduce risks, i.e. reduce the agency costs. The most central mechanism is arguably market competition. However, this mechanism alone is not enough to prevent opportunistic behaviour in agents (Shleifer & Vishny, 1996). Several mechanisms have been seen relevant to include in this section. Among them are board of directors, ownership structure, and managerial ownership. These mechanisms influence each other and provide assurance and risk-reducing measures with the intent of improving firm performance.

2.2.1. Mechanisms in Corporate Governance

Board of directors:

The board of directors holds the ultimate decision-making power within the firm. Directors' role and influence are important to corporate governance performance, as found in Fama and Jensen (1983); Weisbach (1988); Jensen (1986); and Florackis (2008). Findings are conflicted on which characteristics are more attractive. Some studies find that larger boards prove more powerful and influential (Pearce and Zahra, 1991). Other studies find the opposite, stating decreased effectiveness, less coordination and worse communication in large boards (Florackis, 2008). Some studies find better firm performance in firms where boards have a higher amount of non-executive directors (Byrd & Hickman, 1992; Rosenstein & Wyatt, 1990). However, others argue that non-executive board members possess less knowledge about the firm, that they do not possess competence relevant to the firm, and take a less involved approach to monitoring of firm activities (Florackis, 2008).

Ownership structure:

Another important corporate governance mechanism is the firm's ownership structure. The apparent discussion seems to be about the effectiveness of large shareholders versus small shareholders. Zeckhauser & Pound (1990) propose large shareholders as the solution compared to smaller shareholders, as they hold a better position through a greater involvement and influence within the firm. They further argue that large shareholders can utilize their increased voting power to better monitor and influence management activities and decision-making to favour shareholders of the firm. Their more involved monitoring abilities can deter opportunistic behaviour from managers. There is also criticism to this favouritism of large shareholders as a corporate governance mechanism. Florackis (2008) agrees that large shareholders play a positive role in reducing agency conflicts, but expresses concern that large shareholders may simultaneously cause conflicts between large and small shareholders.

Managerial ownership:

Another corporate governance mechanism is found in managerial ownership. This proposes a novel idea to principal-agent conflict, and includes agents as part of the solution. The effectiveness of this mechanism is based on the idea that agents/managers will reduce opportunistic behaviour if they have financial incentives through ownership in the firm (Florackis, 2008). This was found to have strong effects for UK and US firms (Ang et al. 2000; Singh & Davidson, 2003; Florackis, 2008). Principal-agent conflicts and associated agency

costs could be reduced by having less separation between ownership and control. Jensen & Meckling (1976) propose a linear relationship between managerial ownership and agency costs, suggesting an incentive to increase managerial ownership as a relevant mechanism for improved corporate governance. Greater managerial ownership through share ownership will incentivize managers to increase monitoring tasks, and thus improve corporate governance. As a sidenote, the effect of managerial ownership as a corporate governance mechanism was found to be stronger linked for high-growth firms (Florackis, 2008).

Several duelling ideas surround the area of corporate governance. In their definition, Shleifer & Vishny (1996) defines corporate governance as how suppliers of financial resources can get assurance that they will receive returns on their investments from corporations. This definition indicates a shareholder primacy view on the term, which foundational work links back to the thought that the sole purpose of a business is to increase its profits (Friedman, 1970). A similar sentiment is also shared by Cadbury (2000) who presents the purpose of corporate governance as the maximization of shareholder value while governing companies. The presence of shareholder primacy has been persistent in corporate governance over several decades (Weinstein, 2019; Clarke, 2023). As a contrast to shareholder primacy in corporate governance, other ideas have recently been presented. Stoelhorst & Vishwanathan (2024) argue that shareholder primacy in corporate governance becomes inefficient when firms become increasingly knowledge driven and the externalities of their activities become increasingly global. This suggests a turn away from shareholder primacy and a turn towards stakeholder primacy in corporate governance. They further argue that corporate governance should protect stakeholders vulnerable to market power and externalities (Stoelhorst & Vishwanathan, 2024). However, this area of research seems to need further clarifications and study.

2.3. Crisis Management

For the context of this section, a general understanding of the term crisis would be useful. A crisis can be defined as a significant event that is uncontrollable and disruptive in nature (Coombs, 2014). It can hurt or threaten an organisation's reputation and image, and may induce other consequences like media scrutiny and distorted public perception (Fink, 1986; Fearn-Banks, 1996). It poses a threat to an organisation that may damage both an organisation's bottom-line and its reputation (Elsubbaugh et al., 2004). Public perception can be influenced through media coverage, which may accelerate the organisation's problems and in turn threaten the organisation's legitimacy (Ray, 1999; King, 2002).

Crisis management and associated processes that prepare, prevent, and manage crises are important to organisational leaders (Barton, 2001). Crisis management aims to avert or manage crises, effectively reducing the negative impact on the organisation. This requires active involvement from senior executives, both in preventive manners and after the fact. Crises demand complex and unfamiliar decision-making (Pearson et al., 1997)

There is also a distinction between crisis management and crisis communication. Crisis management encompasses organisational efforts to prevent or manage crises (Pearson & Clair, 1998). After a crisis has happened, legitimacy and reputational problems create a need for crisis communication. The organisation must take action to heal its image and reputation post-crisis (King, 2002). Handling media coverage is an important facet to crisis communication, as stakeholders often learn about crises and organisational information through the media. Consequences of not handling negative media coverage can be that stakeholders disengage with the organisation or seek alternatives. This makes handling of the media a central part in crisis communication (Coombs, 2007). A history of previous crises in an organisation was also found to inflict greater reputational damage to an organisation (Coombs, 2007).

2.3.1. Crisis Communication

Repairing reputational damage to the organisation can be done through post-crisis communication (Coombs & Holladay, 2002). To repair reputational damage to organisations, several theoretic approaches have been developed. These approaches build on the works of Coombs (2007). He presents an empirical framework for organisational identification of crisis type attributes and appropriate post-crisis communication strategies for organisations (Coombs, 2007; Coombs & Holladay, 2002). This framework is presented as *Situational Crisis Communication Theory (SCCT)*. It builds on the assumption of three organisational responses to a crisis: denial, diminish, rebuild. The effectiveness of these strategies lies in what context they are used and the attributes of the crisis (Coombs, 2007; Coombs, 2006; Coombs & Holladay, 2002).

Denial:

Denial is a strategy that intends to create a narrative that minimizes the organisational association of the crisis in question. The purpose is that no reputational damage can happen to the organisation if there is no association to the crisis. This approach may play out when an organisation denies any allegations or rumours of misconduct, and tries to remove any legitimate connection to a crisis. Another approach may be to attack the accuser and find a

scapegoat. The goal of this approach is that stakeholders accept there is no legitimate connection between the organisation and the crisis (Coombs, 2006; Coombs, 2007). Denial strategies can be risky to use. If allegations denied by the organisation are refuted by credible evidence, the organisation may face greater reputational damage and loss of stakeholder support. This strategy is deemed more effective when the organisation carries strong evidence against any allegations (Coombs, 2007). Few studies have, however, found empirical evidence of this strategy and its effectiveness in practice.

Diminish:

Diminish is a strategy that intends to reduce the perceived scale of the crisis or the organisation's perceived control over the situation. Similarly to denial strategies, the organisation tries to reduce the connection between itself and the crisis. However, this is done to reduce the culpability of the organisation and to ensure that negative effects of the crisis can be mitigated. For this strategy and narrative to be effective, it is important that the evidence of these claims seem credible. If contradicting or alternative narratives or claims seem more credible, these are likely to be accepted to the demise of the organisation (Coombs, 2006; Coombs, 2007). In cases where public perception aligns with the organisation's narrative, diminish strategies are effective as the organisation can reinforce its narrative. Diminish strategies are also effective for accidental crises, as the organisation can downplay its culpability (Coombs & Holladay, 2002; Coombs, 2007).

Rebuild:

Rebuild is a strategy that intends to repair the organisational image following a crisis. This is done through offering material or symbolic assistance to those affected by the crisis. Such assistance can take form in apologies or compensations, trying to prevent further reputational damage (Coombs, 2006; Coombs, 2007). Organisations that used rebuild strategies were found to get more positive reputational effects than those using diminish strategies (Claeys et al., 2010). Rebuild strategies are effective when the crisis carries potentially significant reputational damage, such as in cases where the crisis seems deliberately caused or when a history of similar crises are followed by an accidental crisis (Coombs, 2007). If the crisis was deemed preventable, rebuild strategies are more effective in restoring reputation (Claeys et al., 2010). However, apologies or compensations may signal legal admissions of guilt which may expose the organisation to lawsuits and legal claims (Fitzpatrick, 1995; Tyler, 1997).

2.4. Conclusion

In summary, this literature review has been an effort to offer a comprehensive view on three chosen topics of literature. Through an assessment of literature in the fields of agency theory, corporate governance and crisis management, this section has assessed theoretic frameworks relevant to describe and analyse the context and content central to this thesis. This assessment has also been an effort to provide applicable frameworks with the dual purpose of shedding light on the business case and for application on the subsequent teaching note.

Agency theory has been used to describe and assess the relationship between the principal and the agent. This theory was further expanded on to describe the triadic relationship and interplay between the client, the bank, and the regulators. This expansion of agency theory was included to assess the role of AML compliance and its effects on agency costs along with the conflict of interests between the three parties. The role of AML compliance was further contextualized to describe its consequences in the financial industry.

Corporate governance was then introduced to describe three chosen mechanisms that can be used to reduce agency costs caused by the conflict of interest from the principal-agent relationship. An assessment of these mechanisms was done to find empirical evidence for their effectiveness in reducing agency costs.

This literature review was lastly concluded through an assessment of theories in the field of crisis management. To limit the scope of literature included, a specific focus was put on crisis communication post-crisis. The assessment on crisis communication found three common strategies used for crisis communication post-crisis. These strategies provided insights for ways organisations can effectively communicate post-crisis to restore or repair reputational damage. Later research found empirical evidence for parts of the effectiveness of these strategies.

In combination, these three topics of literature provide a conceptual ground useful for business case and the teaching note. The topics demonstrate synergies by describing the relationship between stakeholders to the firm, empirically based mechanisms to reduce agency costs stemming from these relationships, and lastly by describing effective ways the organisation can communicate post-crises to restore or repair its reputation.

For further research, it would be interesting to have new studies on the effectiveness of other mechanisms to reduce agency costs. A more nuanced perspective on crisis communication strategies would also be interesting, as current literature builds on and is derived from the works of a single author.

3. Teaching Note

3.1. Learning Objectives

The case of DNB aims to provide an in-depth exercise in the strategic implications and processes between financial institutions and regulatory bodies. It aims to provide an evaluation of conflicting stakeholder interests that may affect a financial institution and its operations. Moreover, the case provides an exercise in evaluating governance mechanisms and reputational management strategies that are relevant for a financial institution.

This case can be a helpful aid for students within courses such as international and strategic management, managerial control, and business communication.

The main learning objectives are as follows:

- Understand DNBs history and struggles with achieving compliance.
- Be introduced to the world of regulation and compliance in the financial services industry.
- Explore strategic implications for financial institutions in being compliant with laws and regulations, namely within a setting of conflicting stakeholder interests.
- Assess and discuss different strategies and tactics a financial institution can use to achieve compliance.
- Evaluate and compare different strategies to minimize financial and reputational damage following an organisational crisis.
- Reflect over internal and external factors that affect compliancy for a financial institution.

3.2. Assignment Questions

The following suggested assignment questions are provided to help students prepare for the in-class case discussion:

- What were DNBs main challenges with compliance in the period between the 2018 AML Act to March 2024?
- Reflect on DNBs efforts to achieve compliance. To what degree have they achieved this?
- In your opinion, was Danske Bank's market exit a sound strategic choice?

3.3. Class Plan

- 1) What were the strategic implications for DNB of the 2018 AML Act?
- 2) How do you evaluate DNB's attitude towards AML compliance before the fines?
- 3) How do you evaluate DNB's response to the Finanstilsynet fines?
- 4) What were the issues or conflict of interests at DNB that contributed to its struggles with AML compliance?
- 5) What alternative strategies could DNB have implemented to achieve compliance earlier?
- 6) How do you evaluate Danske Bank market exit? What were the main lessons of this move for DNB?
- 7) What are the main challenges that DNB is facing at the time of the case, by March 2024?
- 8) What are your recommendations for the management of DNB?

3.4. Analysis

- 1) What were the strategic implications for DNB of the 2018 AML Act?

The new law emphasized the pressure on compliance in financial institutions. DNB was the largest bank in Norway, and the potential pitfall of non-compliance was arguably greater for them compared to smaller, regional banks. New standards for compliance and control were introduced by the new law. This also meant an increased need for transparency between the divisions at the bank. DNB consequently formed Group AML in 2019 to cluster divisions working with AML and sanctions. Upper management at DNB also took a greater interest in AML following the new law.

The change to a risk-based approach introduced a larger scope of work for AML compliance (Pellegrina & Masciandaro, 2008). DNB needed to increase its headcount and investments in onboarding, continuous training of employees and managers, technology, and consolidation and structure of procedures and tasks. Finanstilsynet also got an increased mandate to give out larger penalties in cases of non-compliance. This meant discrepancies or faulty work could lead to strategic setbacks in the form of reputational and financial damages, as found in Naheem (2020). As a result, DNB put a greater emphasis on internal control within the bank to reduce discrepancies and to ensure precise work. There was consequently a greater need for necessary investments.

Greater investments meant a need for organisational change. Investments in, and prioritization of, AML compliance likely had negative effects on other departments' budgets at DNB, or for margins overall. A strain on resources forced the bank to adjust its budgets to improve compliance standards following the law's requirements. Budget constraints from AML prioritization following the law could also impact competition for resources between departments and/or budget cannibalization.

Implementation issues following the law could also bring cultural challenges at DNB. New and extensive requirements created a need for more collaborative efforts across departments. More isolated departments with low cohesion to others would gain advantages by joining forces and reduce departmental friction. Collaboration between departments could improve compliance standards. In 2018, DNB was rated below the industry average on consumer bank preferences. The bank thus needed to balance its effort to improve customer satisfaction ratings alongside adjusted and improved AML compliance. This could be solved through collaborative efforts between customer facing departments and AML departments to achieve improvement in both areas. Such efforts could also create synergies at DNB. Increased customer knowledge from improved KYC collection on the AML side could positively spill over to customer facing departments who could improve their value offer to customers. Similarly, improved customer satisfaction would likely make collection of KYC easier and faster.

Implementation of the new law and the risk-based approach might also have impacted morale at DNB, which increases organisational burden (Razavy & Haggerty, 2009). Employees used to old procedures might feel resistance towards changes and new ways of conducting business at the bank. Such resistance can cultivate scrutiny, low morale, or sub-optimization of organisational goals. This could in turn increase internal agency costs within DNB (Jensen & Meckling, 1976).

There were also other strategic dimensions to implementation of the new law. DNB focused on transparency after 2018. Efforts for increased transparency with the public could reap possibilities but also threats. By showcasing a legitimate and proactive effort in accordance with the law, DNB could garner increased trust, and be seen as a stable and reliable bank. DNB could potentially use this image to position itself as the leading bank both in market size and security in the Norwegian market. Such an image could lead to a competitive advantage. However, increased transparency about its work with AML could also unveil its skeletons and past misdoings. Poor handling of AML in the past could negatively affect DNB's current image.

2) How do you evaluate DNB's attitude towards AML compliance before the fines?

The introduction of the 2018 AML Act raised public awareness of AML. The public learned what it entailed, the consequences of non-prevention, and money laundering as a societal issue. DNB therefore had a stronger incentive to portray itself as a secure institution. One that took the issue seriously. One that did not allow criminal activity, and one that actively prevented efforts at money laundering through its channels and financial products.

In the period leading up to the fines, DNB handled AML compliance differently from how it handled the issue after. When Bjørn Knutsen entered the bank, AML was an important field. It was prioritized as an important business area within the bank and he expressed no feelings that AML was a trivial issue at DNB. However, there was also a sentiment that AML efforts and matters related to compliance was something mainly discussed among specialists and experts in the bank. Outside of relevant circles, AML seemed less prioritized. Upper management were less involved, and it seemed like an isolated issue that was solely on the agenda for AML departments. AML compliance was something that had to be done, but that otherwise did not garner much attention elsewhere. Although DNB noticeably geared up its efforts in AML compliance after the 2018 AML Act, one can argue that DNB did not prioritize AML enough, as showcased by its fines three years later.

Several possibilities can be pointed to for why AML compliance was less prioritized at DNB before the fines. DNB is a large cap bank with many employees. Implementing changes often takes time in large organizations. For large changes, outside pressure is often needed as well as internal stakeholders that push for change. The AML Act of 2018 could have spearheaded a change at DNB, and shown that the issue of AML compliance needed to be put on the agenda to a greater degree. However, it seemed the external pressure was not sufficient. Due to AML compliance mainly being discussed between specialists and relevant departments, internal pressure also seemed less apparent.

Another possibility may lie in AML and its nature. AML and processes related to it do not drive or create profit, at least not directly (Pellegrina & Masciandaro, 2008). AML induces direct costs for a business, which it accepts to prevent other direct costs such as fines and daily penalties. This outcome is supported in Naheem (2020). Specialized employees and investments in technology is costly. It was also difficult finding significant new changes to KYC and collection of customer data, contributing to its unfavourableness. The matter of taking on direct costs to prevent potential future direct costs and reputational damage introduces

complexity to the decision-making. This complexity may drive an unwillingness to invest in or prioritize AML. Potential penalties are also harder to budget for and foresee than direct costs from investments in compliance processes. It can therefore be speculated that significant advancements in AML efforts had a lower priority than improving financial margins for DNB. This would mean a presence of agency costs between DNB and regulators (Eisenhardt, 1989; Pellegrina & Masciandaro, 2008). A fear of losing business due to advancements in AML could also have contributed to its attitude towards AML compliance.

3) How do you evaluate DNB's response to the Finanstilsynet fines?

Before the fines, DNB had made efforts to prioritize AML compliance and improve their standards. The AML Act of 2018 and associated increased public awareness had put AML on the agenda at DNB. The bank had improved risk assessment and monitoring tasks, increased headcount in relevant compliance divisions, and restructured AML divisions. Upper management's increased involvement also meant better board oversight and involvement, improving the bank's corporate governance, as found in Florackis (2008) among others. After the fines, it seemed DNB realized that AML was not an isolated business area only dealt with by specialists in the organisation. DNB also made attempts at legal claims against the fines, but to no avail. Instead, it seemed that the fines forcefully taught DNB a lesson. AML needed to be made visible internally in the bank, AML efforts needed to be made more transparent internally, and upper management needed to prioritize the issue more.

Several changes were consequently made in response to the fines. Upper management got more involved and followed the AML progress closely. DNB adjusted processes, hired more manpower to AML departments, and communicated clear expectations internally. This showcased a positive change as regulatory obligations were becoming more prioritized. DNB also started publicizing reports about the bank's work with AML and current trends and threats. This was a proactive effort to demonstrate DNB's prioritization of AML and to actively engage with regulators and the public. This effort to educate the public and communicate with regulators also draws similarities to rebuild strategies in crisis communication, as a form of symbolic assistance (Coombs, 2006; Coombs, 2007). Bjørn Knutsen's general expression of wanting clarifications on what Finanstilsynet expects for compliance in financial institutions also demonstrates a willingness to collaborate with regulators.

Despite the setbacks and ramifications from the fines, DNB was able to implement changes to improve its compliance standards. The fines could have impeded growth and represented a downwards spiral for the bank. Despite escalating and improving its AML efforts before the fines, DNB was able to continue implementing necessary changes for further improvement after the fines as well. This demonstrated a willingness for organisational change.

- 4) What were the issues or conflict of interests at DNB that contributed to its struggles with AML compliance?

When looking back at what underlying issues or patterns at DNB may have caused it to end up in a situation facing fines and non-compliance, several factors can be mentioned. Non-compliance leading to the fines was no ideal situation for DNB, and something it should have fought to prevent to a greater degree. DNB faced difficulty foreseeing its fines. This difficulty can be contributed to by the complex landscape the bank found itself in at the time. For one, the period leading up to the first fine in 2021 was affected by lower profitability in the banking sector due to the pandemic and a period of low interest rates. Simultaneously, this time-period saw a rise in fintech and paytech adoption and similar changes in digital banking solutions. These changes acted disruptively to the banking sector. The societal and industry changes introduced by novel banking methods and unfamiliar capabilities could have acted distracting to DNB and its decision-making at the time. Similarly, it is also a possibility that the ever-complex competitive banking landscape in Norway and globally added to DNBs difficult decision-making. Increased competitiveness in the banking sector and poor consumer ratings could have played a role in distracting DNBs prioritization away from AML and its compliance efforts (See Exhibit 5).

DNB as a private bank holds a responsibility to its shareholders to be profitable (Friedman, 2007). In its pursuit of profit, and while navigating in a homogenous market such as banking, DNBs pursuit of profit may have trumped concerns over potential discrepancies in its efforts towards AML compliance. The prioritization of corporate governance to maximize shareholder value while governing firms is found in Cadbury (2000). This prioritization may have caused short-termism in DNBs decision-making, prioritizing profit-driving ventures over budgeting and prioritizing efforts to improve its standards in AML compliance and meeting or superseding requirements put forth after the 2018 AML Act. This would be in line with profit maximization and shareholder primacy (Weinstein, 2019; Clarke, 2023). Managers and employees at DNB

may have been incentivized to prioritize time and resources towards profit-driving ventures over AML compliance. This may have happened due to the latter being cost-driving, thus supporting theories of shareholder primacy.

The conflict of interest between responsibility to shareholders versus responsibility to meet requirements from Finanstilsynet can be actualized through the lens of agency theory. The bank acts as agent, and is tasked with pleasing the often-opposing interests of regulators and clients (Naheem, 2020; Pellegrina and Masciandaro, 2008). DNB was put in a difficult situation regarding how best to please its two principals' interests. Clients in this sense could be seen as both customers and shareholders. In retrospect, DNB seem to have chosen to dedicate most of its time and resources towards pleasing its clients. This meant a prioritization away from regulators, thus resulting in agency costs and punishments from its unfavoured principal in the form of fines (Naheem, 2020; Pellegrina & Masciandaro, 2008). The intricate manoeuvre of pleasing both principal's interests seemed to be too complex of a task for DNB at that time. It is worth mentioning that the Norwegian state owned 34% of DNBs shares, meaning the it had stakes in both principals. It had interests in the regulator side as Finanstilsynet is a subsidiary of sorts to the Norwegian state. Similarly, the Norwegian state also held direct interests in DNB through significant share ownership. These conflicting interests also add complexity for DNBs road to achievement of AML compliance.

5) What alternative strategies could DNB have implemented to achieve compliance earlier?

DNB had many hardships achieving compliance, and its two rounds of fines demonstrated weaknesses in its strategic compliance efforts. Recognizing its shortcomings with AML compliance means admitting the existence of an organisational problem and the presence of agency costs. It would have been beneficial for DNB to recognize its struggles with AML compliance at an early stage. This would have prompted an analysis of the root causes for its inability to reach compliance. Analysing potential organisational and cultural issues would have detected any obstacles or areas of friction that hindered effective prioritization and execution of AML compliance. This perspective actualizes the question of what alternative strategies DNB would have gained more from to achieve compliance at an earlier stage.

DNB would have gained from utilizing creative problem-solving to solve its issue of non-compliance. This could be done through new approaches that incentivized customers to fulfil

the bank's AML obligations. One way to incentivize customers to hand in KYC information or customer IDs faster could be by using the threat of overdue fines. This method would put the pressure onto the customers. Another possibility could be through clever use of marketing campaigns. For example, taking use of the increased public awareness of AML following the 2018 AML Act and playing to this by using awareness campaigns. This could have positive effects for DNB besides compliance. Awareness campaigns could have positive spillover effects for DNBs image as a reliable bank. It could be seen as a bank that conducts responsible business. This could also be seen as symbolic assistance (Coombs, 2006; Coombs, 2007). Given that DNB was rated below industry average in consumer preferences in this time-period, such awareness campaigns could play an important role in erecting its position with consumers. (See Exhibit 5)

More proactive engagement with Finanstilsynet is another intuitive recommendation. DNB made few attempts at reaching out to Finanstilsynet in the wake of the 2018 AML Act and after its first AML related fine in 2021. The bank attempted legal claims against the decision of the fines, but this could be seen as more of a reactive and futile attempt. DNB should have improved its communication with regulators and made attempts at fostering a better relationship preventively, and simultaneous, to its struggles with compliance.

The 2018 AML Act meant stricter requirements for DNB and set higher standards for the bank's efforts to become compliant. The first fine from Finanstilsynet similarly raised expectations for DNB and its room for improvement. These were instances DNB could have come better out of had it proactively engaged and communicated with regulators. By communicating with Finanstilsynet to understand its expectations they could have reached actionable suggestions for more efficient compliancy. This would in turn have improved the bank's situation. Active communication could also have reduced differences between the two, and softened the already strained relationship (Pellegrina & Masciandaro, 2008; Naheem, 2020). This could potentially have led to more lenient timelines for compliance, and clear expectations from Finanstilsynet regarding necessary improvements. Unclear expectations for compliance seemed retroactively to have been an issue for DNB, as Bjørn Knutsen described it.

As the largest bank in Norway, DNB should to a greater degree have been able to foresee its impending issues with compliancy at an earlier stage. DNBs shortcomings with the AML Act that led to its first fine, and its struggles with collecting customer IDs for most of its customers within the deadline can be seen as neglectful by DNB. This may have resulted from an inability

to recognize internal shortcomings such as inefficiencies organisationally, processes that were not effective or a lack of expertise or organisational oversight. Had DNB recognized its struggles earlier, it could have allocated necessary resources to AML compliance earlier. This would have improved its ability to detect, monitor and collect necessary customer information to prevent receiving fines and daily penalties. An inability to recognize internal shortcomings or an apparent friction against preventive change should have been avoided. DNB could have engaged external auditors or consultants to get an unbiased and clear report on the bank's ability to handle the new and strict requirements as well as received actionable steps for effective compliance.

Large shareholders such as the Norwegian state could also have actively advocated for preventive measures and increased prioritization of compliance efforts. Although this would have included a temporary increase in costs, the long-term firm results would improve due to a retained reputation and no costly fines. Large shareholders' effectiveness in influencing positive changes and reducing agency conflicts is supported by Zeckhauser & Pound (1990) and Florackis (2008).

- 6) How do you evaluate Danske Bank market exit? What were the main lessons of this move for DNB?

Danske Bank announced its exit from the Norwegian personal customer market in the summer of 2023. This announcement came after a multiple year-long battle with coercive fines imposed on the bank from Finanstilsynet due to subpar AML compliance. Danske Bank had made several reassurances about progress to Finanstilsynet, and made several pleas for leniency and extended timelines. No preferential treatment was given, and Danske Bank endured continuous daily penalties from 2020 until market exit. The fines were hardly the single reason for Danske Bank's market exit from the Norwegian personal market, but were nonetheless a decisively contributing factor.

The daily penalties and their costly ramifications represented a period of duress for Danske Bank. The bank faced an uphill battle against regulators who rejected their attempts at reaching compliancy with the law. There comes a time where continuing to endure fines becomes too much of a burden. Seen in a cost-benefit scenario, the longer time the fines continued, the less strategically viable it seemed to continue improving processes and AML efforts to please regulators' harsh demands. This may have pushed Danske Bank to reevaluate its market fit in

the Norwegian market, prompting them to prioritize its core strengths and to restructure its core services.

Pellegrina & Masciandaro (2008) and Naheem (2020) argued for a limit to how far a financial institution should go to achieve compliance and prevent penalties for non-compliance. This perspective included a scenario where costs related to achieving compliance overturned the potential costs of penalties from non-compliance. The perspective posited that alternatives to compliance efforts would be more rational if reaching a state of compliance became too costly. This perspective can be further developed in the case of Danske Bank. Allowing costs for improvement of AML compliance and simultaneously enduring year-long substantial costs from daily penalties was a limited sustainable venture for the Danish bank. It can be argued that Danske Bank at some point realized that achieving compliance would no longer be a financially viable project. The bank likely reached a rational limit to compliancy in the Norwegian market, as presented in Pellegrina & Masciandaro (2008) and Naheem (2020).

The case of Danske Bank can act as a cautionary tale for DNB. Danske Bank's market exit, heavily influenced by regulatory scrutiny, should have acted as a warning to DNB. Although DNB are unlikely to consider a strategic exit from its own domestic market, seeing a foreign competitor pressured to market exit by regulatory scrutiny should be taken as a serious testament to the importance of compliance with regulators' expectations. This should raise the stakes for DNB and its pressure to become compliant.

There are valuable lessons presented in Danske Bank's struggle with regulators and its solution to exit the Norwegian market. A multiple year long struggle to reach compliancy can eventually lead to a point of no return. By understanding the project of reaching compliancy in a cost-benefit scenario, DNB can make informed decisions. The case of Danske Bank should further motivate DNB to allocate resources, time, and effort towards compliance in due time. It should motivate DNB to engage proactively with regulators and the public to foster a good relationship. It should motivate DNB to regularly reassess their risk management, compliance standards and internal processes and culture to diagnose any discrepancies or shortcomings. Similarly, DNB should regularly assess its own ability to respond to external pressure and changes. This is relevant for changes in laws and regulations, and for changes in economic, social, or technological factors that may affect the banks operational landscape. These efforts would strengthen DNBs position in the face of regulatory scrutiny and external changes.

7) What are the main challenges that DNB is facing at the time of the case, by March 2024?

At this time in the case, DNB's main challenge is to collect the remaining customer IDs from personal and corporate clients. This work will be complete when Finanstilsynet recognizes the bank's collection of customer IDs as "satisfactory fulfilled." When this status is reached, the daily penalties DNB are forced to pay will end. This is the most immediate and pressing challenge DNB faces at this time of the case. In Bjørn's words, this work is close to completion. However, it will be important for DNB to not reduce its efforts towards reaching this status.

Another challenge DNB are currently facing is to improve its relationship with Finanstilsynet. After 3 years of continuous shortcomings regarding AML compliance, DNB likely does not hold a favourable position in the eyes of regulators. Improving this relationship will be an important challenge for DNB in the time to come. Fostering a better relationship between DNB and Finanstilsynet will be an important step towards sustainable compliance efforts in the years to come.

A similar challenge lies in restoring public perception of DNB and to recover from reputational damage. This means improving its relationship with the public. Several years of unfavourable media coverage regarding compliance and DNB's ability to handle compliance and regulatory requirements means that restoring the bank's image as a reliable and secure bank will be important. DNB has been through a crisis of compliance, and post-crisis communication can therefore be a relevant strategy to repair reputational damage (Coombs & Holladay, 2002). Focusing on ways to communicate or change the narrative of its struggles with reaching compliance will be an important challenge for DNB going forward.

Another possible challenge DNB faces at this time may be low morale (Razavy & Haggerty, 2009). After having dealt with regulatory scrutiny, organisational changes, and process adjustments for several years it is likely that morale at DNB has taken a hit. Improving morale through a collective effort at increasing compliance standards will be an important area of focus for management at DNB. Similarly, upper management should recognize the potential that morale has been reduced in the organisation and take this matter seriously. Low morale will make organisational changes difficult, can lead to more internal friction, and may result in decreased productivity.

Another challenge for DNB is that its struggles with compliance in its domestic market may be repeated abroad. DNB has an international presence, especially in the Nordic Region. Safeguarding against similar regulatory issues abroad will therefore be important to keep in

mind. There may also be concerns related to a potential competitive vacuum left over by Danske Bank's sale of its personal customers to the competitor, Nordea Bank. This competitor may change the competitive banking landscape in Norway through its suddenly increased market size. Similarly, foreign competitors may see opportunities for entry into a disrupted Norwegian banking market after Danske Bank's exit. DNB could also assess if its shortcomings with AML compliance is present in other areas as well. Improvements in AML compliance may have synergies to improvements in marketing and sales. DNB should consider if an improved understanding of its customers through collection of KYC can lead to opportunities and an improved product-market fit through marketing and sales efforts.

8) What are your recommendations for the management of DNB?

The red thread in DNB's handling of its fines, its implementation of changes, and its relationship with regulators and the public seems to culminate in a lack of proactivity. DNB responded reactively to the 2018 AML Act by seemingly increasing its focus on AML compliance. It budgeted for its AML efforts, hired specialists, and focused on ongoing training of employees specialized in AML. At the same time, AML was a separate and isolated business division. The 2018 AML Act did not represent a holistic organisational change at DNB. Upper management had limited involvement with AML, and the field was seemingly isolated to its relevant departments without much attention or involvement from other parts of the bank.

After the first fine, DNB acted reactively yet again. The fine highlighted the bank's flaws in its handling of AML compliance. The scale and repercussions of the fine also gave public pressure to DNB, which was then forced to escalate its efforts in AML compliance. When the subsequent coercive fine hit DNB, it was a symbolic blow to a bank already licking its wounds. The common denominator seems to be no to little proactive efforts or proactive improvements from the bank regarding compliance or for fostering a better relationship with regulators and the public. Therefore, cultural, and organisational changes seem relevant. The bank needs a more holistic approach to compliance. It must utilize synergies, such as through collaborative efforts between AML and customer facing departments, and view AML compliance as an organisational task more than a departmental issue. In other words, management at DNB needs to change the bank's view on AML compliance from reactive to proactive.

Management at DNB also needs to prioritize fostering a better relationship with both regulators and the public, as actualized in Pellegrina & Masicandaro (2008) and Naheem (2020). For an

improved relationship with regulators, more proactive communication to reach a mutual understanding of AML expectations is suggested. For an improved relationship with the public, demonstrating and externalizing more of the bank's work and prioritization of AML compliance seems relevant. Currently, DNB publishes annual reports on threats and trends and AML work and through workshops. Management needs to evaluate what more similar efforts they can make public to showcase and market DNBs AML efforts. This could help showcase an altruistic side to DNB through education of the public, and as a bank that prioritizes corporate social responsibility. It would simultaneously showcase DNBs serious stance on its prioritization of compliance. This effort would be in line with the rebuild strategy, which is an effective strategy to repair organisational image following a crisis (Coombs, 2006; Coombs, 2007).

Another issue that should be put on the agenda is DNBs potential agency conflicts. The conflict of interest between prioritizing financial gain over prioritization of compliance seems apparent. DNB struggled to balance its responsibility towards the interests of shareholders as well as to the interests of regulators. Management needs to manoeuvre a solution between the two that secures long-term profitable balance of AML compliance. In line with corporate governance theories, it seems like a fair suggestion for DNBs management to advocate for increased involvement from majority shareholders (Zeckhauser & Pound, 1990; Florackis, 2008). Through greater involvement and monitoring, these can help reduce agency conflicts at DNB, and help reduce the potential dissonance between management's prioritization of financial gain versus prioritization of AML compliance.

4. Conclusion

Writing the case of DNB and their challenges with AML compliance has been a rewarding experience. This work has presented how financial institutions can be affected by regulatory frameworks, regulatory scrutiny and how they can implement changes to rectify past mistakes and find solutions in a complex situation.

The choice of using DNB for this case was twofold. Firstly, DNB was the largest bank in Norway at the time. Secondly, DNB as a partly state-owned bank should arguably have close ties to the tune of political and legal changes. The situation of DNB finding itself in a regulatory predicament was therefore very interesting. The choice of topic for this business case was rooted in my personal experiences working with anti-money laundering at another Norwegian bank not mentioned by name in this case.

Through the work on this thesis, I have gained an informative understanding of how financial institutions can struggle with balancing multiple stakeholder interests. DNBs work with AML compliance have demonstrated the intricate decision-making apparent for large organisations. It was also informative to include the situation of Danske Bank and draw parallels to DNB. Writing the business case shed light on management issues previously unbeknownst to me, and demonstrated trade-offs and strategic choices done in a large-cap financial institution. The literature review provided an informative overview over academic theories relevant for the context of this case. The conflicting nature of agency conflicts was surprising and actualized the problematization of stakeholder interest in new ways for me.

Given more time and a longer thesis length, it would be interesting to include a more comparative view with how other banks in the Norwegian market have dealt with strict AML requirements or compliancy issues. Given that both DNB and Danske Bank have had struggles meeting strict AML standards, it would be valuable to include other banks experiences as well. It would also be favourable to get the perspective of other people from upper management at DNB, also from those less involved with AML. Another aspect that would be enriching would be to include Finanstilsynet, and actualize how they view incentives for improved AML compliance in the financial services industry. Regarding potential future developments, there seems to be potential for improvements on the regulator side as well as for financial institutions. It will be exciting to see if Finanstilsynet and other regulatory bodies find alternative ways to incentivize financial institutions to improve AML compliance.

Appendices

Case Exhibits

Exhibit 1: AML/CFT risk level index for European Union and Western Europe, by Basel Institute (2022)

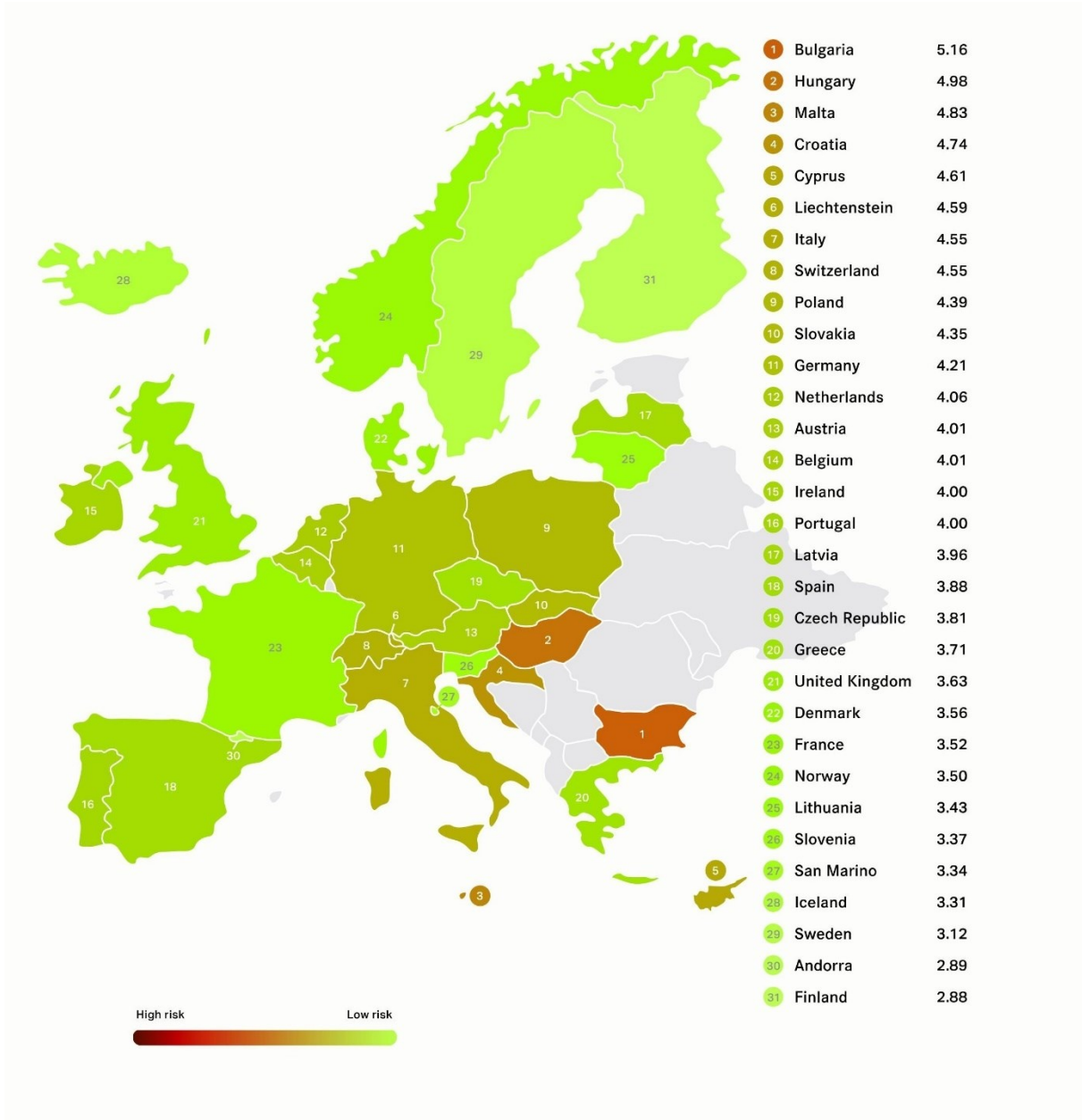


Exhibit 2: Management Organisation Chart of DNB, by DNB (2024).

Konsernledelsen fra 14. august 2023

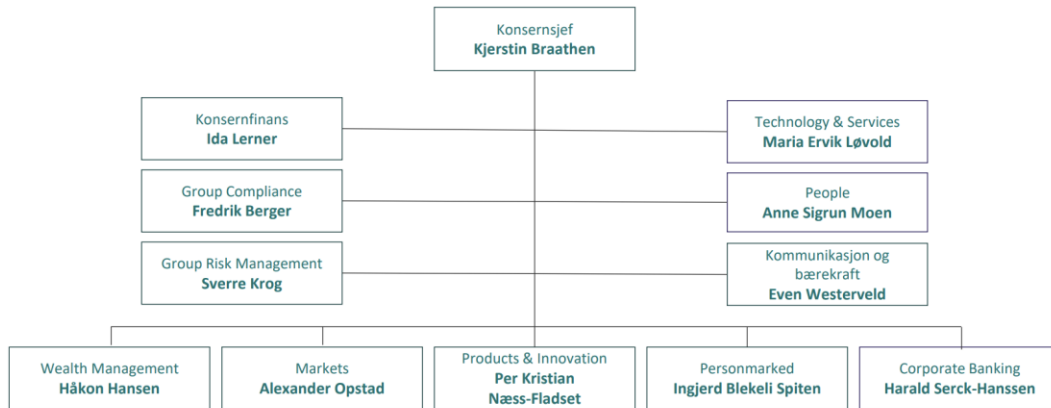
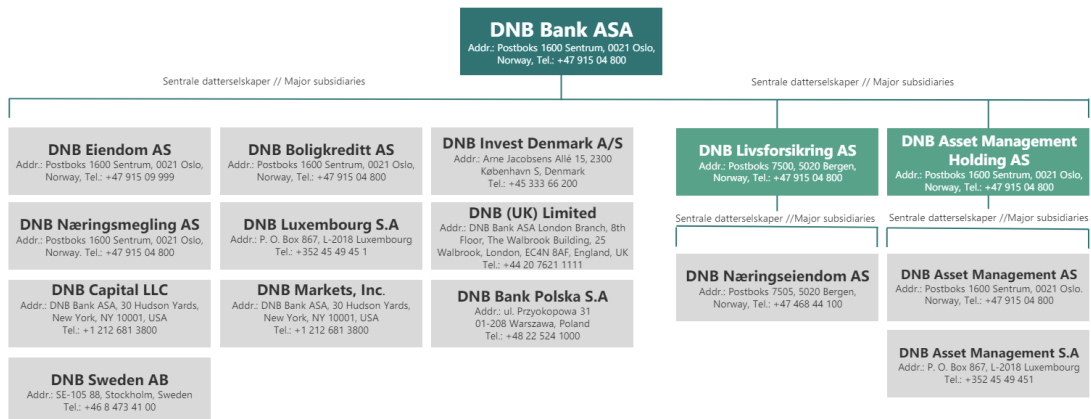


Exhibit 3: Legal Structure of DNB, by DNB (2024).

Juridisk organisering av DNB // Legal entities in DNB



Per 30. november 2023 // As at 30 November 2023

100 % direkte eller indirekte eid av DNB Bank ASA // 100 % directly or indirectly owned by DNB Bank ASA

Exhibit 4: DNB Headquarters in Oslo, Norway.



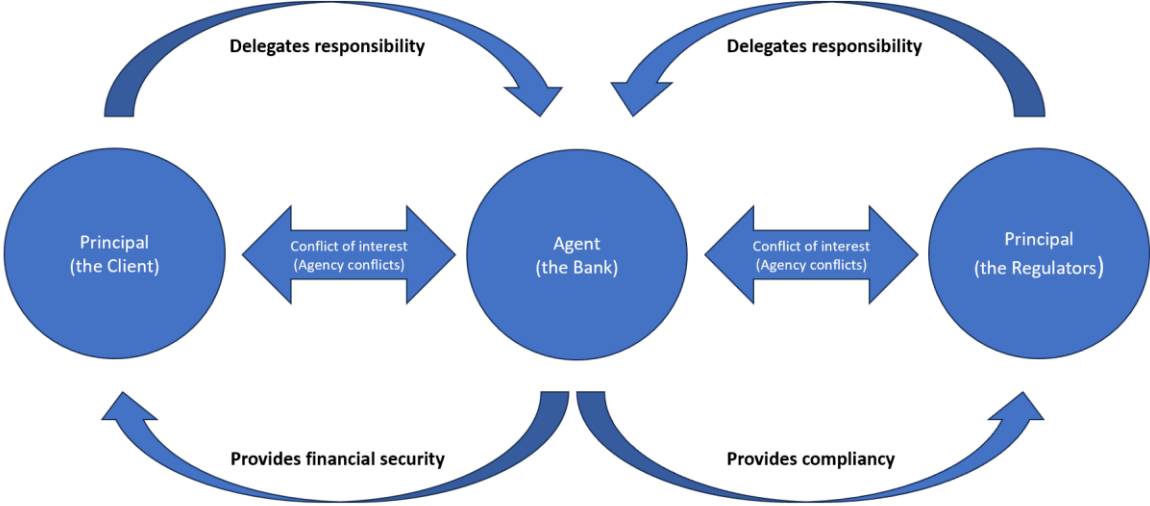
Exhibit 5:

Yearly Trend in Consumer Bank Preferences: DNB versus Industry Average						
	2018	2019	2020	2021	2022	2023
Personal Customers						
DNB	67.5	66.2	63.6	64.2	63.1	61.5
Industry Average	71.6	70.9	69.7	69.7	69.5	67.7
Corporate Clients						
DNB	68.6	69.9	64.1	63.0	63.0	62.3
Industry Average	69.9	70.6	67.6	65.1	67.0	66.0

Data obtained from EPSI Rating Norge (2023).

Literature Review Exhibit

Exhibit 1: The Principal-Agent-Principal-relationship (Naheem, 2020; Pellegrina and Masciandaro, 2008).



Methodology

This section of the Appendix will briefly describe the methodology of primary data in this research.

This Thesis can best be described as a single-case study. These studies have clear limitations on time and allow for rich insights into a situation. Given this characterization it was deemed relevant to use qualitative data. Individual interviews are a common data collection method used for single-case studies. This is relevant when there are few participants, and the participant's perspective and understanding is central (Jacobsen, 2016). Primary data was therefore collected through an individual interview with an insider employee at DNB. He held a managerial role in AML at DNB, allowing for rich insights into relevant decision-making processes at DNB. His role also ensured he was competent in the field of AML. His personal experiences and perspective on the situation in the time-period of this case was also valuable.

I established contact with this insider through email, where we scheduled an initial phone conversation. This conversation was a preliminary step, ensuring a mutual understanding of what topics the Case would include, and what information he could provide. A subsequent online interview on MS Teams was then conducted some days later, due to geographical limitations at the time. For this interview a semi-structured interview guide with a set of questions and general topics was used. The interview opened with easy questions in the start, followed by more complex questions and topics in the middle, before it was concluded with more general topics in the end. This approach is supported by Jacobsen (2016). The semi-structured interview guide ensured flexibility and allowed for nuances and follow-up questions during the interview (Jacobsen, 2016). The interview lasted around 60 minutes. Some correspondence was also done after the interview, to clarify certain aspects.

An important part of any research project is research ethics. One main category in research ethics is the protection of participants (Tangen, 2014). The insider employee at DNB wished to anonymize his name, and this wish was respected. Achievement of complete anonymity is difficult in qualitative studies. Names and identifying answers must be anonymized as much as possible (Haugen, 2021). The insider at DNB was made aware of this, and the anonymization of his name was sufficient in his view.

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