HARMONIZING GOVERNANCE, RISK MANAGEMENT, AND COMPLIANCE
THROUGH THE PARADIGM OF BEHAVIORAL ETHICS RISK

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ABSTRACT

Governance, risk management, and compliance (GRC) are critical functions within companies—this much we know. Yet business leaders remain largely unsure of how to manage these functions effectively. The evidence is both anecdotal, as seen by recent corporate scandals, and research-based, as business law scholars levy sustained critiques against corporate compliance and governance effectiveness. At least part of the failing of GRC stems from its lack of coherent theory; there has been little attempt to harmonize the various GRC functions and determine what is at their core. Instead, the business and academic community has been content with the simple acknowledgment that GRC contains both "overlaps" and "differences" among its components. This Essay offers a more principled analysis. It argues that governance, risk management, and compliance can best be understood through a behavioral ethics risk paradigm. Using behavioral ethics, criminological, and network theory, the Essay explains that individual unethical decision making within the firm is at the heart of "conduct risk," which in turn is at the core of GRC. When conduct risk is misunderstood and ignored—as is the case in most companies—it not only creates corporate compliance lapses, but it may also cause systemic risk that can swamp corporate governance. Once this dynamic is understood, effective GRC can be properly seen as an exercise in managing behavioral ethics risk within the firm. After providing the necessary theoretical framework, the Essay turns to the practical, offering strategies companies can use to identify and mitigate this newly understood risk.

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INTRODUCTION

"Governance, risk management, and compliance are in vogue."[1] That is how the leading GRC textbook describes these three overlapping corporate functions. Whether something as staid as GRC can ever be in vogue is debatable—after all, the purpose of risk management and compliance is often to *lessen* the effects of trendy or superficial governance and business practices. But it is true that these functions have become more visible, and therefore arguably more important, than in the past. Fueled by corporate scandals beginning in the 1960s and intensifying in the early and mid 2000s, risk management and compliance have taken on prominent roles in corporate America. Indeed, it would be hard to find a sizable company that does not commit a significant amount of resources to addressing business risk and regulatory compliance, a claim that could hardly be made a few decades earlier.

On the whole, this is a good thing given the laudable goals of risk management and compliance. Risk management is aimed at identifying, analyzing, and planning for various risks the company faces, all with the intention of mitigating them so business can function more effectively. The goal of compliance is to make sure the company is following applicable laws and norms. The two functions overlap in substance and form: non-compliance, either by individual employees or on the organizational level, creates risk; and both compliance and risk can be managed by targeted organizational processes. Thus, a company that puts in place processes to lessen compliance failures will consequently lesson its "conduct risk," which ultimately leads to more effective corporate governance.[2]

The nature of this relationship has led some to suggest that risk management and compliance have overtaken corporate governance within companies—the R and C have swallowed the G, as it were.

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[1] GEOFFREY P. MILLER, THE LAW OF GOVERNANCE, RISK MANAGEMENT, AND COMPLIANCE 1 (2017).

[2] Conduct risk can be defined as "unethical business practices, individual behaviors, and organizational behaviors that have led to outcomes that have harmed either individual players or the financial system." Deloitte, *Conduct Risk: Improving Culture Across the Enterprise*, WALL ST. J. (May 14, 2018), http://deloitte.wsj.com/riskandcompliance/2018/05/14/conduct-risk-improving-culture-across-the-enterprise/. *See also*, Tom Butler, et al., *A Systematic Approach for Managing and Supervising Conduct Culture and Risk*, GOVERNANCE, RISK & COMPLIANCE TECH CENTER, at 2-3 (2017), http://www.grctc.com/wp-content/uploads/2017/08/GRCTC-Conduct-Risk-2017-_-Final.pdf.

Again, whether that is accurate is debatable, but this much is clear: if a company has not been paying attention to GRC, and especially to risk caused by compliance failures, it better start. That is because everyone else is—employees, directors, investors, regulators, and even competitors—essentially every stakeholder that has the power to impact the company.

But saying that governance, risk management, and compliance are important or even in vogue only goes so far. What corporate leaders truly care about is how to *manage* these functions effectively. Unfortunately, there has been a longstanding lack of guidance in this area. If GRC began its rise to current prominence in the 1960s, then there has been roughly a half-century of trying to determine "what works and what hurts" without much resolution.[3] Reasons for this abound—regulators, corporate leaders, and third-party providers are all to blame—but the fact remains that GRC's increased importance has not resulted in a corresponding increase in its efficacy. This fact has been lamented in both corporate and academic circles.[4] While we seem to have more and fancier corporate tools and metrics these days, we remain unclear on how best to use them.

With that in mind, this Essay suggests a new theoretical construct for GRC, one organized around the concept of *behavioral ethics risk management*. This approach, which works inside-out from compliance to governance, offers a better way to understand the risks associated with compliance failures and how to combat them to improve corporate governance. What this paradigm does better than existing notions of GRC is to focus on what is at the heart of these related functions: individual ethical decision making. Drawing from the fields of behavioral ethics, criminology, and network theory, this Essay will explain how individual unethical decisions are made, how that leads to compliance failures, and how those failures may spread throughout a company.[5] This discussion will highlight how risk

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[3] *See* Linda Klebe Trevino et al., *Managing Ethics and Legal Compliance: What Works and What Hurts*, 41 CAL. MGMT. REV. 131 (1999) (exploring efficacy of deterrence-based compliance programs in Fortune 1000 firms).

[4] *See e.g.*, Kimberly D. Krawiec, *Cosmetic Compliance and the Failure of Negotiated Governance*, 81 WASH. U. L.Q. 487, 491, 510–15 (2003) (arguing that "a growing body of evidence indicates that internal compliance structures do not deter prohibited conduct within firms" and finding little support for their inclusion as a central feature of negotiated governance).

[5] The paradigm argued for in this Essay culminates from my work on corporate compliance and behavioral ethics. *See e.g.*, Todd Haugh, *The Criminalization of Compliance*, 92 NOTRE DAME L. REV. 1215 (2017); Todd Haugh,

emanating from unethical employee decision making, if left unaddressed, may result in significant risk to the firm.

Once this newly understood risk is identified and explored, the Essay turns to how best to mitigate it. A series of risk assessment and compliance strategies are offered, ones that properly focus on the decision making processes of individual employees, as opposed to the command-and-control oriented tools of traditional corporate compliance and governance. Again, the idea is to move past accepted practices, even those that are considered current "best practices," to focus on reducing individual unethical decisions, the precursors to unethical behavior and corporate wrongdoing. By employing these strategies, companies may reduce their conduct risk and allow for more efficient and effective operations, the overarching goal of all companies' GRC efforts.[6]

I. BEHAVIORAL ETHICS RISK: WHAT IT IS AND HOW IT SPREADS

A. GRC and Its Ethical Decision Making Core

As an initial matter, it is helpful to consider the relationship between corporate governance, risk management, and compliance—the three aspects of GRC. As others have pointed out, these functions are distinct within corporations, yet they clearly overlap in ways that are more than "simpl[e] matters of definition."[7]

The most straightforward way to conceptualize the relationship is as a set of concentric circles, with compliance at the center, risk

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Nudging Corporate Compliance, 54 AM. BUS. L.J. 683 (2017); Todd Haugh, *The Power Few of Corporate Compliance*, 53 GA. L. REV. 1 (forthcoming 2019) [hereinafter, *Power Few*].

[6] I am mindful that offering this new GRC paradigm can sound both grandiose and pedestrian at the same time. On the one hand, theories of ethical decision making go back a long way, at least as far as Aristotle, so it is hard to claim novelty here. And because companies are legal fictions that can only act through their agents, it may seem obvious that everything within a company originates from the decision making of individuals. The insight I hope to provide by using the paradigm of behavioral ethics risk comes from bringing theory and practice from divergent fields together and refocusing GRC on what matters—individual ethical decision making. Understanding how ethical decision making occurs, how it creates small-bore and systemic risk, and how it can be targeted to increase compliance and mitigate conduct risk are topics many in corporate governance and compliance ignore. *See* Haugh, *Power Few*, *supra* note [ ], at 26 (discussing common assumptions underlying compliance risk and governance).

[7] MILLER, *supra* note [ ], at 3.

management as the second ring, and corporate governance as the third. This structuring recognizes that each function occupies a distinct definitional and substantive role in a company, but that all serve a common purpose; that is, to ensure the company is effectively managed to meet its welfare enhancing goals. It also recognizes that the compliance function is central to GRC. This makes sense as non-compliance by members of an organization creates risk that must be managed if effective governance is to be achieved. Figure 1 shows this relationship and provides the basic definitions of each component.[8]

Figure 1: GRC relationship and component definitions

Governance—processes by which decisions relative to risk management and compliance are made within organizations

Risk management—processes by which risk is identified, analyzed, and included in strategic planning, and either mitigated or accepted as inherent in necessary company conduct

Compliance—processes by which a company polices its own behavior to ensure legal and normative conformity

EDM—ethical decision making of individuals

Because compliance is central to GRC efforts, it is important to understand in more detail what the function entails. Although compliance is a broad concept, it can be thought of as having two primary purposes. The first is deterring violations of law, which may be criminal or civil in nature. On the criminal side, compliance programs are aimed at preventing violations of state and federal law, as well as regulatory violations that may be criminally enforced.[9] In addition, compliance programs attempt to prevent tort-based violations of purely civil law.[10] Put another way, compliance

[8] Definitions adopted from MILLER, *supra* note [ ], at 2-3.

[9] *See* Sean J. Griffith, *Corporate Governance in an Era of Compliance*, 57 WM. & MARY L. REV. 2075, 2082 (2016).

[10] *See* Tanina Rostain, *General Counsel in the Age of Compliance: Preliminary Findings and New Research Questions*, 21 GEO. J. LEGAL ETHICS 465, 467 (2008)

programs attempt to deter *all* aspects of unlawful employee behavior, which reduces the risk that the company will be held responsible under broad *respondeat superior* legal liability.[11]

The second purpose of compliance is to generate positive behavioral norms within the company. Internal corporate norms, which are expressed by the company through rules, guidance, and mores, are important because they fill the gaps left by more formal legal mechanisms.[12] Norm generation and enforcement is often considered the "ethical culture" aspect of compliance, and a majority of companies see creating an ethical culture as the larger goal of their compliance programs.[13] The hope is that through these efforts all employees will share a common belief about the company's "purpose (i.e., mission, strategy, and goals) . . . [and] the necessary means to achieve it (i.e., systems, structure, and processes)[.]"[14]

In order to achieve these two purposes, compliance simultaneously operates on multiple levels within a company. Education and training, the first level, is essentially "policy-setting" by the company to its employees.[15] The company explains what the applicable laws and corporate policies are and how employees (and other stakeholders) should comply with them. Monitoring, the second level, ensures that those corporate policies are understood and followed, and that any violations are quickly identified.[16] Enforcement, a third level, attempts to deter future violations by punishing wrongdoers.[17] Often this means a reprimand, but

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(discussing role of compliance to enforce sexual harassment and anti-discrimination laws).

11 *See* Harvey L. Pitt & Karl A. Groskaufmanis, *Minimizing Corporate Civil and Criminal Liability: A Second Look at Corporate Codes of Conduct*, 78 GEO. L.J. 1559, 1570–74 (1990).

12 Miriam H. Baer, *Governing Corporate Compliance*, 50 B.C. L. REV. 949, 960 (2009).

13 Griffith, *supra* note [ ], at 2093–94, n.73.

14 Caterina Bulgarella, *Predicting Risk: A Strategic Culture Framework for the C-Suite*, SAI GLOBAL, at 10, https://m.comms.saiglobal.com/res/saiglob_mkt_prod1/SAI_Global_Strategic_Culture_Framework_Report_April2018.pdf.

15 Griffith, *supra* note [ ], at 2093. Some call this the advising function of compliance. James A. Fanto, *Advising Compliance in Financial Firms: A New Mission for the Legal Academy*, 8 BROOK. J. CORP. FIN. & COM. L. 1, 9 (2013).

16 Donald C. Langevoort, *Monitoring: The Behavioral Economics of Corporate Compliance with the Law*, 2002 COLUM. BUS. REV. 71, 81.

17 Griffith, *supra* note [ ], at 2097.

termination is common for ethical transgressions.[18] Legal violations by employees, however, may result in a range of more serious sanctions for both the individual and the company. These types of compliance violations in particular create significant conduct risk for firms.[19]

It should be obvious from the above that much of compliance—and therefore much of risk management and corporate governance—turns on individual employee behavior. If directors, managers, and lower-level employees act in a law-abiding and ethical manner, the company will likely avoid legal liability and significant compliance-based disruption of its business practices. This means that companies' intent on creating effective compliance programs must develop the "skill [of] predicting human behavior."[20] But behavior is predicated on individual decision making, in this instance ethical decision making. Thus, the core of compliance, and in turn much of GRC, is dependent on individual ethical decision making—the sphere at the center of Figure 1.

B. Individual Ethical Decision Making and Behavioral Ethics

This concept, that individual ethical decision making is at the heart of the concentric functions of GRC, is likely to be edifying for many companies.[21] Yet even for those organizations that have already come around to this view, there is often scant understanding of how employees make ethical decisions, and even less understanding of how to incorporate that information into GRC practices. Luckily, the field of behavioral ethics—and the behavioral science behind it—provides significant insights, laying the foundation for the behavioral ethics risk management paradigm.

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[18] *Id*.

[19] For example, Siemens A.G. reported spending more than $1 billion solely related to the government's inquiry into the payment of foreign bribes by individual executives. The reputational and operational costs were much higher. *See* Peter J. Henning, *The Mounting Costs of Internal Investigations*, N.Y. TIMES (Mar. 5, 2012), http://dealbook.nytimes.com/2012/03/05/the-mounting-costs-of-internal-investigations/?_r=0.

[20] Donald Langevoort, *Behavioral Ethics, Behavioral Compliance*, *in* RESEARCH HANDBOOK ON CORPORATE CRIME AND FINANCIAL MISDEALING [1] (Jennifer Arlen ed., 2016) [hereinafter *Behavioral Compliance*].

[21] And some legal and business academics too.

1. The behavioral ethics field and its central findings

Likely because it is a still-emerging field, there is no standard definition of behavioral ethics. Early proponents broadly characterized it as the "scientific approach for studying perceptions of how we ought to treat one another . . . and how such perceptions influence behavior."[22] While that was a useful start because it made clear that ethical behavior could be studied systematically, to really understand what behavioral ethics is, it is necessary to take a more practical approach. Thus, a better way to define the field is the "aim[] to understand how even well-intentioned people can sometimes behave unethically."[23] Going a step farther, and more closely linking behavior and decision making, behavioral ethics can be defined as the study of the "systematic and predictable ways in which individuals make ethical decisions and judge the ethical decisions of others."[24]

These last two definitions hint at the central findings of the many studies conducted under the behavioral ethics umbrella. That is, "cognitive heuristics, psychological tendencies, social and organizational pressures, and even seemingly irrelevant situational factors can make it more likely that good people will do bad things."[25] In plain terms, behavioral ethics research tells us that while most people are moral individuals intent on doing right, we are not as ethical as we think we are. Another way to consider this finding is that ethical decision making and behavior are *limited* in a significant way. Most people will make moral decisions in line with their ethical beliefs, but only up to a point. Because of cognitive obstacles, which may be exacerbated by external factors, many people will be blind to their own unethical conduct—they engage in unethical acts without even realizing it, acts that they would

[22] Robert Folger, *Deonance: Behavioral Ethics and Moral Obligation*, *in* BEHAVIORAL BUSINESS ETHICS 125 (David De Cremer & Ann E. Tenbrunsel eds., 2012).

[23] Jason Dana et al., *Ethical Immunity: How People Violate Their Own Moral Standards Without Feeling They Are Doing So*, *in* BEHAVIORAL BUSINESS ETHICS 202 (David De Cremer & Ann E. Tenbrunsel eds., 2012).

[24] Max H. Brazerman & Francesca Gino, *Behavioral Ethics: Toward a Deeper Understanding of Moral Judgment and Dishonesty*, 8 ANN. REV. LAW SOC. SCI. 85, 90 (2012).

[25] Robert Prentice, *Behavioral Ethics: Can It Help Lawyers (and Others) Be Their Best Selves?*, 29 NOTRE DAME J.L. ETHICS & PUB. POL'Y 35, 36 (2015).

condemn upon further reflection.[26] As one leader in the field put it, we are ethical, but "only boundedly so."[27]

2. The decision making theory underlying behavioral ethics

The central findings of behavioral ethics research provide a crucial understanding of individual ethical decision making, but left open is the question of how. How does the ethical decision making process operate so that it falls prey to these cognitive obstacles, which leads to us to commit unethical behavior?

For the answer, it is necessary to consider dual process theory, or the notion that "human thought processes are subserved by two distinct mechanisms."[28] Put simply, the theory suggests that we make decisions through two separate minds sharing space in our single brain. Jonathan Evans and Keith Frankish provide a concise summary:

> These theories come in different forms, but all agree in positing two distinct processing mechanisms for a given task, which employ different procedures and may yield different, sometimes conflicting, results. Typically, one of the processes is characterized as fast, effortless, automatic, non-conscience, inflexible, heavily contextualized, and undemanding of working memory, and the other as slow, effortful, controlled, conscious, flexible, decontextualized, and demanding of working memory.[29]

To add a bit more context, the fast or intuitive process, now generally referred to as System 1, is "evolutionally old, and shared with most higher animals."[30] It operates by associative memory; therefore, it is governed by habit and difficult to control or modify. System 1 thinking may not seem like thinking at all because so much happens through it all at once. The speed and ease in which this

[26] *See* YUVAL FELDMAN, THE LAW OF GOOD PEOPLE: CHALLENGING STATES' ABILITY TO REGULATE HUMAN BEHAVIOR 3-4 (2018) (discussing psychological foundations of behavioral ethics).

[27] Prentice, *supra* note [ ], at 36.

[28] LAURI JÄRVILEHTO, THE NATURE AND FUNCTION OF INTUITIVE THOUGHT AND DECISION MAKING 24 (2015) (internal citation omitted).

[29] JONATHAN ST. B. T. EVANS AND KEITH FRANKISH, IN TWO MINDS: DUAL PROCESSES AND BEYOND 1 (2009).

[30] JÄRVILEHTO, *supra* note [ ], at 25.

thinking system operates means that "most of the work of associative thinking is silent, hidden from our conscious selves."[31]

In contrast, the slower reasoning process, or System 2, is evolutionally recent, typical to humans and likely only the most advanced primates.[32] System 2 is "serial, effortful, and deliberately controlled," subject to logic and rules—it is engaged whenever we use thought in an organized manner.[33] The effort that this type of thinking requires is significant, but it is how the brain carefully addresses new tasks when there are no easy associations to make. System 2 thinking, unlike its more automatic counterpart, gives us the "experience of agency, autonomy, and volition."[34] The features of each thinking system are shown in Table 1.

Table 1: Dual systems of thinking

System 1—Automatic thinking	System 2—Reflective thinking
Associative	Deductive
Effortless	Effortful
Uncontrolled	Controlled
Fast	Slow
Emotional	Rule-following
Subconscious	Self-aware
Evolutionarily old	Evolutionarily recent
Shared with animals	Distinctively human
Non-linguistic	Linguistic
Low cognitive load	High cognitive load

Based on these descriptions, it is tempting to view System 2 as superior to System 1, but that not entirely accurate. Because System 1 thinking is associative and not constrained by working memory, it is virtually effortless and therefore highly efficient.[35] In fact, because it can process several streams of information at once, System 1 is uniquely suited for making the vast majority of our daily decisions, everything from walking and talking to driving a car and brushing ones teeth.

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[31] DANIEL KAHNEMAN, THINKING, FAST AND SLOW 52 (2011).

[32] JÄRVILEHTO, *supra* note [ ], at 25.

[33] Daniel Kahneman, *Maps of Bounded Rationality: Psychology for Behavioral Economics*, 93 AM. ECON. REV. 1449, 1451 (2003) [hereinafter, *Bounded Rationality*].

[34] Pelle Guldborg Hansen & Andreas Maaloe Jespersen, *Nudge and the Manipulation of Choice: A Framework for the Responsible Use of the Nudge Approach to Behaviour Change in Public Policy*, 4 EUR. J. RISK REG. 3, 13 (2013).

[35] Jonathan St. B.T. Evans, *In Two Minds: Dual-Process Accounts of Reasoning*, 7 TRENDS COGNITIVE SCI. 454, 454 (2003).

But for more important decisions, System 2 thinking is required to ensure a thoughtful, and potentially more accurate, outcome. The difficulty is that because of the greater cognitive load required to employ System 2, it is easily overwhelmed.[36] This results in a series of cognitive limitations that "typically manifest as the inability to focus attention."[37] The cause of these limitations is that effortful mental processes disrupt each other, while effortless ones do not. Thus, System 1 thinking tends to proliferate when we are under significant cognitive load, which is anytime we are facing non-routine decisions.[38]

This last point is important because it reveals the perceived versus actual relationship between our dual systems of thinking. While most of us believe that we make decisions carefully and deliberately, the behavioral research demonstrates that can only be true for a small subset of decisions.[39] There simply is not enough mental energy to give every decision the treatment it requires. Instead of making most decisions through the reflective system, studies show that System 1 is the dominant mode of thinking.[40] As such, the most we can hope for is that System 2 operates as a watchful monitor, kicking in when really important mental tasks arise or when it is needed to correct a decision making error.[41] But that necessarily means that some decisions, even important ones, will slip through the cracks and be made subject to biases, heuristics and other mental shortcuts based on quick associations and limited cognitive processes.

3. Dual system thinking and ethical decision making

Although dual system theory was developed independent of questions related to ethical decision making, it serves as the

[36] Id. at 457.

[37] JÄRVILEHTO, *supra* note [ ], at 26.

[38] *Id*.

[39] Kahneman, *Bounded Rationality*, *supra* note [ ], at 1467.

[40] *Id*. Jonathon Haidt uses the image of a rider on an elephant to explain the relationship between System 1 and 2 thinking. The rider is System 2, which tries to steer the more powerful System 1 elephant under him, often unsuccessfully. *See* JONATHON HAIDT, THE HAPPINESS HYPOTHESIS: FINDING MODERN TRUTH IN ANCIENT WISDOM [ ] (2006).

[41] KAHNEMAN, *supra* note [ ], at 44 ("One of the main functions of System 2 is to monitor and control thoughts and actions 'suggested' by System 1, allowing some to be expressed directly in behavior and suppressing or modifying others.").

foundation for the central findings of behavioral ethics—that individual ethical decision making is bounded, even when we intend to behave ethically.[42] Behavioral ethics researchers believe that self-interest is associated with System 1, the automatic thinking system.[43] A majority of researchers also believe that individuals approach ethical decisions in a way that "grants System 1 the leading role," causing us to initially "prefer outcomes that benefit ourselves."[44] In other words, making unethical decisions, or at least ones that preference our own wellbeing over others, is likely our default decision making condition.

But as we know from dual system theory, that is not the end of the story. Once System 2 has been activated, prompting thoughtful reflection, people often do "choose to behave in an ethically appropriate manner."[45] Just as in other decision making contexts, behavioral ethics researchers have found that System 2 can act as a watchful *ethical* monitor, jumping in to control the automatic self-interest each of us possess.[46] This monitoring function appears to work best when cognitive load is low and individuals are able to fully consider the ethical ramifications of a decision—these are the conditions in which we are most likely to act in a way consistent with our morals.[47] However, when cognitive load is high, the automatic system may supplant the reflective, increasing the chance that individuals will act according to their less ethical self-interests.[48]

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[42] FELDMAN, *supra* note [ ], at 33-35.

[43] *Id*.

[44] Yuval Feldman, *Behavioral Ethics Meets Behavioral Law and Economics*, *in* THE OXFORD HANDBOOK OF BEHAVIORAL ECONOMICS AND THE LAW 8 (Eyal Zamir and Doron Teichman eds., 2014); Minette Drumwright et al., *Behavioral Ethics and Teaching Ethical Decision Making*, 13 DECISION SCI. J. INNOVATIVE EDUC. 431, 433 (2015); Nicholas Epley & Eugene M. Caruso, *Egocentric Ethics*, 17 SOC. JUST. RES. 171, 179 (2004).

[45] Feldman, *supra* note [ ], at 8. *But see* David G. Rand, et al., *Spontaneous Giving and Calculated Greed*, 489 NATURE 427 (2012) (finding that cooperation is intuitive and automatic, possibly because cooperative heuristics are developed in daily life where cooperation is typically advantageous).

[46] Kahneman, *Bounded Rationality*, *supra* note [ ], at 1467.

[47] Don A. Moore & George Loewenstein, *Self-Interest, Automaticity, and the Psychology of Conflict of Interest*, 17 SOC. JUST. RES. 189, 193 (2004).

[48] Feldman, *supra* note [ ], at 8; Moore & Loewenstein, *supra* note [ ], at 193.

C. Rationalizations as the Link between Unethical Decision Making and Unethical Behavior

The central findings of behavioral ethics, as well as the decision making science underlying it, has significant ramifications for companies trying to predict and mitigate the conduct risk generated by its employees. Increasing System 2 thinking related to ethical decisions would seem to be an obvious path toward increasing GRC effectiveness. Unfortunately, however, the story is a bit more complicated. That is because System 2 thinking itself is part of the cause of unethical and illegal acts in business.

To understand this, we have to turn to those researchers even more steeped in the study of unethical behavior than behavioral ethicists: criminologists. As far back as the 1940s, criminologists studying white collar and organizational crime have theorized how offenders move from unethical decision making to unethical behavior.[49]

In his classic study of embezzlers, criminologist Donald Cressey found that three conditions are necessary for a white collar or occupational crime to occur. First, an individual must possess a non-shareable financial problem, *i.e.*, a problem the person feels cannot be solved by revealing it to others.[50] Second, the individual must believe that the problem can be solved in secret by violating a trust.[51] Trust, of course, is essential to the operation of all organizations—the entire principle-agent and employer-employee relationship is built upon it.[52] Third, the individual must verbalize the relationship between the non-shareable problem and the unethical or illegal solution in "language that lets him look on trust violation as something other than trust violation."[53] Put another way, the

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[49] *See e.g.*, Edwin H. Sutherland, *White-Collar Criminology*, *in* DELINQUENCY, CRIME, AND SOCIAL PROCESS 349 (Donald R. Cressey & David A. Ward, eds. 1969) (reprint of article drafted in 1940 by Sutherland, who is considered the "Godfather" of white collar crime, regarding causal theories of white collar criminality).

[50] Donald R. Cressey, *The Respectable Criminal*, 3 CRIMINOLOGICA 13, 14–15 (1965). While this sounds sophisticated, it usually is not; the problem could be anything from gambling debts to business losses, anything that matters from "the psychological perspective of the potential offender."

[51] MARK M. LANIER & STUART HENRY, ESSENTIAL CRIMINOLOGY 168 (3d ed. 2004).

[52] JOHN R. BOATRIGHT, ETHICS AND CONDUCT OF BUSINESS 33-34 (2012).

[53] Cressey, *supra* note [ ], at 15.

individual conducts an internal dialogue that "reasons" the trust violation as acceptable. The paradigmatic example is a bank teller convincing himself that he is only "borrowing" the embezzled funds and will pay them back.[54]

This last step, what criminologists call "verbalizations," has been called as "the crux of the problem" of white collar and corporate crime.[55] Criminologists do not view verbalizations as simple, after-the-fact excuses that offenders use to relieve their culpability upon being caught. Instead, they see verbalizations as "vocabularies of motive," words and phrases used by offenders that label unethical behavior as appropriate.[56] Importantly, this means that an offender's rationalizations are created *before* the unethical or illegal behavior occurs. "The rationalization is [the offender's] motivation"—it not only justifies his behavior to others, but it makes the behavior intelligible, and therefore actionable, to himself.[57] Thus, rationalizations permit behavior to proceed that would otherwise be unacceptable to an offender. Table 2 sets forth the eight most common rationalizations used by white collar offenders and examples of corresponding verbalizations.[58]

Table 2: White collar rationalizations

Rationalization	**Definitional example**
Denial of Responsibility	*"I am not a criminal, what I did was an accident"* or *"it was an emergency, I needed it"*
Denial of Injury	*"nobody got hurt"* or *"I did not steal, I just borrowed"*
Denial of the Victim	*"I am the real victim"* or *"they got what they deserved"*
Condemning the Condemners	*"the government is corrupt or unfair"* or *"the law and the government are unjust"*
Appeal to Higher Loyalties	*"I did it for the company"* or *"I always help out a friend"*
Metaphor of the Ledger	*"I've done more good than bad in my life"*
Claim of Entitlement	*"I deserve this"* or *"I have earned the right to have this"*
Claim of Relative Acceptability/Normality	*"there are others worse than me"* or *"everybody else is doing it"*

[54] *Id.*

[55] *Id.*

[56] *Id.*

[57] DONALD R. CRESSEY, OTHER PEOPLE'S MONEY: A STUDY IN THE SOCIAL PSYCHOLOGY OF EMBEZZLEMENT 94, 95 (1973).

[58] The definitional examples are drawn from Paul Michael Klenowski, "Other People's Money": An Empirical Examination of the Motivational Differences Between Male and Female White Collar Offenders 56, 67 (May 2008) (unpublished Ph.D. dissertation, Indiana University of Pennsylvania) (on file with author) (internal citations omitted).

The concept of rationalizations is so powerful—and so critical to understanding unethical and illegal employee acts—because it provides the bridge between individual ethical decision making and unethical behavior. Behavioral ethics research suggests that we default toward unethical decision making, and therefore unethical action, because we are driven by self-interested System 1 thinking.[59] At the same time, criminological research tells us that we come up with ways to convince ourselves—consciously and subconsciously—that we are acting ethically.[60] This is System 2 thinking justifying our System 1 conclusions. Essentially, we have developed a mechanism to accommodate the countervailing aspects of living in a "hypersocial" world that rewards self-interested behavior but also social cooperation.[61] That mechanism is to rationalize—redefining how we look at our own behavior so as to square our self-perception as a "good person" with the self-interested unethical or illegal behavior we are contemplating.[62] In a way, rationalizations trick the System 2 reflective thinking process that would otherwise intervene to contain the "automaticity of self interest."[63] This is not a product of intentional amorality for most people; instead, they are blind to the "correction their mind applies as it weighs ethical concerns against other motives."[64]

D. The Spread of Unethical Behavioral within Organizations

Admittedly, this does not paint a very rosy picture for corporate compliance or a company's larger GRC efforts. If the behavioral ethics and criminological research suggest that both System 1 and System 2 are feeding unethical decision making and behavior,

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[59] FELDMAN, *supra* note [ ], at 44.

[60] Feldman, *supra* note [ ], at 7, 17; Cressey, *supra* note [ ], at 15.

[61] Elizabeth Kolbert, *That's What You Think: Why Reason and Evidence Won't Change Our Minds*, NEW YORKER, at 66 (Feb. 27, 2017) (citing HUGO MERCIER & DAN SPERBER, THE ENIGMA OF REASON: A NEW THEORY OF HUMAN UNDERSTANDING [ ] (2017). *See also*, Jonathon Haidt, *The Emotional Dog and Its Rational Tail: A Social Intuitionist Approach to Moral Judgment*, 108 PSYCHOL. REV. 814, 818 (2001) (describing "that moral reasoning is an effortful process, engaged in after a moral judgment is made, in which a person searches for arguments that will support an already-made judgment).

[62] Vikas Anad et. al, *Business as Usual: The Acceptance and Perpetuation of Corruption in Organizations*, 18 ACAD. MGMT. EXEC. 39, 40-43 (2004).

[63] Feldman, *supra* note [ ], at 3, 7 (calling the "automaticity of self-interest" one of behavioral ethics basic tenets).

[64] Bulgarella, *supra* note [ ], at 7.

companies would appear to be fighting an uphill battle against employee wrongdoing and the risk it creates. Unfortunately, the picture gets worse before it gets better. That is because behavioral ethics research also suggests that unethical behavior can spread easily within companies through social and organizational networks, ratcheting up the conduct risk companies face.

We have long known that social and organizational ties can have significant impacts on ethical behavior.[65] But only recently have we come to understand the behavioral mechanisms behind those impacts. One group of researchers coalescing around Francesca Gino has published a series of studies addressing whether being exposed to the unethical behavior of others to which you have an association increases dishonesty.[66] Gino and her colleagues found that student participants who observed other students from the same school cheat on a task were much more likely to cheat themselves.[67] This was not the case when the participants observed cheating from non-affiliated students.[68] Another study found that when student participants felt "psychologically close" to cheating students, the participants cheated in higher numbers themselves and viewed selfish behavior as "less unethical or wrong."[69] Taken together, these and other studies suggest that "people copy the behavior of in-group members," using that behavior to justify and rationalize their own unethical conduct.[70]

These findings take on special significance when considering the natural networks—social and organizational—that exist within companies. If close connections and in-group dynamics influence unethical behavior, that means individuals who are joined by psychological closeness, even if it is slight, may be more prone to commit violations of laws or norms when others around them are doing so.[71] And when these individuals are linked together in a

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65 FELDMAN, *supra* note [ ], at 48; Trevino et al., *supra* note [ ], at 138-41.

66 *See e.g.*, Francesca Gino, Shahar Ayal & Dan Ariely, *Contagion and Differentiation in Unethical Behavior: The Effect of One Bad Apple on the Barrel*, 20 PSYCHOL. SCI. 393 (2009); Francesca Gino & Adam D. Galinsky, *Vicarious Dishonesty: When Psychological Closeness Creates Distance from One's Moral Compass*, 119 ORG. BEHAV. & HUM. DECISION PROCESSES 15 (2012).

67 Gino, Ayal & Ariely, *supra* note [ ], at 396-97.

68 *Id.*

69 Gino & Galinsky, *supra* note [ ], at 23.

70 Cilea Moore & Francesca Gino, *Ethically Adrift: How Others Pull Our Moral Compass from True North, and How We Can Fix It*, 22 RES. ORG. BEHAV. 53, 57 (2013).

71 Gino & Galinsky, *supra* note [ ], at 23. *See also*, Kristin Smith-Crowe &

network, the number and harm of those violations increases. In other words, individual wrongdoing can be "contagious," spreading quickly through an organizational network in unexpected ways.[72]

Sociologist and network theorist Mark Granovetter's study of how riots occur supports this proposition. Granovetter posited that potential rioters—the persons in a crowd milling around and witnessing the group's actions—have a "threshold" for joining.[73] This threshold differs for each participant based on their own ethical decision making, *i.e.*, the level at which their mind allows potential bad behavior to be operationalized. Granovetter created a model that assigned 100 potential rioters a number from 0 to 99, which corresponded to their individual thresholds—the person with the zero threshold would begin rioting all on his own, the person with the 1 threshold would see one person rioting and join in, on and on until the last person joined.[74] This model suggested that riots would "grow like wildfire, eventually sucking in even people with very high [individual] thresholds."[75] But the model also suggested that if just one person early on had a slightly higher threshold, say a 6 instead of a 4, the riot would end before it gained momentum because the next threshold would never be reached.

This simple model led Granovetter to better understand actual riot behavior, in which the "equilibrium number of rioters" does not build uniformly, but rather appears to jump up drastically at a certain point.[76] He modeled that riot size would increase by a factor of seven—an explosion more than a wildfire—after crossing a seemingly arbitrary point.[77] Granovetter suggested that this phenomenon was caused by the relationships between the active and potential rioters; he believed friendships were lowering individual thresholds to joining the riot. Accordingly, if some number of people in the crowd were friends with multiple people rioting, the

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Danielle E. Warren, *The Emotion-Evoked Collective Corruption Model: The Role of Emotion in the Spread of Corruption Within Organizations*, 25 ORG. SCI. 1124, 1165 (2014) (study providing a model showing how corruption might spread through emotion even to well intentioned and morally engaged population).

[72] Gino, Ayal & Ariely, *supra* note [ ], at 398.

[73] Mark Granovetter, *Threshold Models of Collective Behavior*, 83 J. SOC. 1420, 1422 (1978).

[74] *Id*.

[75] MARK BUCHANAN, NEXUS: SMALL WORLDS AND THE GROUNDBREAKING SCIENCE OF NETWORKS 107 (2002).

[76] Granovetter, *supra* note [ ], at 1428.

[77] *Id*. at 1425.

overall riot participants would skyrocket along with the harm caused. Granovetter called this the "bandwagon" effect.[78]

This finding is consistent with behavioral ethics research. Granovetter's modeling shows how individual ethical decision making, as influenced by personal relationship, creates significant conduct risk. When there is an in-group relationship between a wrongdoer and others in the group, the others' thresholds to unethical behavior are lowered. And if one or more of the wrongdoers is an important part of a network of related individuals, they possess an outsized ability to lower many thresholds all at once. This spreads bad behavior in an unpredictable and highly volatile manner—it becomes contagious. Thus, a company's social and organizational network—and who within it is making unethical decisions and committing unethical acts—can greatly impact the ethicality of the *entire* organization.[79] This is how a few individual unethical decisions can translate into systemic behavioral ethics risk for a company.

III. BEHAVIORAL ETHICS RISK: MANAGING A NEW PARADIGM

The above offers a more accurate—and arguably more challenging—paradigm of GRC, one that is organized around individual unethical decision making. This is the root cause of compliance failures and the driver of significant conduct risk facing companies. Which begs the question: how can business leaders and compliance professionals manage this newly identified risk?

The short answer is that behavioral ethics risk can be managed through the same means by which it originates. By understanding, targeting, and even harnessing the ethical decision making processes occurring at the individual employee level, companies can increase compliance and build ethical culture. That is to say, they can increase GRC from the inside-out, helping employees understand and adapt their own ethical decision making to foster positive behavior. As individual ethical transgressions are lessened, so is the spread of bad conduct, allowing ethical culture to grow organically within the organization—all of which lessens behavioral ethics risk.

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[78] *Id*. at 1429 (describing two factors that have a role in changing the effects of threshold distributions, including "social structure").

[79] *See* Gino, Ayal & Ariely, *supra* note [ ], at 397 (suggesting unethical behaviors such as cheating, stealing, and dishonesty are "contagious" within business organizations).

While there are no quick fixes, the following offers a series of strategies companies can employ as part of their GRC efforts.

A. Assessing Individual Employees' Behavioral Ethics Risk

Companies can begin managing behavioral ethics risk at the hiring process by screening for it. While many companies look at past employment history, bankruptcies, and criminal violations in order to identify potential wrongdoers, these are imperfect indicators of individual ethical decision making. Instead, companies can explicitly screen for propensity to make ethical decisions. For example, prospective or probationary employees can be asked to take the Defining Issues Test, which questions respondents on how they would address a series of moral vignettes, providing an ethicality assessment based on the principle of justice.[80] Another assessment, the Mach IV, determines a person's propensity toward Machiavellian-type behavior, or the lack of concern with conventional morality.[81] These diagnostic tools have been around for years and are well validated; yet they have not been widely used in business to identify conduct risk.

In addition, researchers have recently developed a scale measuring rule orientation and behavior.[82] This tool may be particularly useful for companies because it assesses how an individual considers rules—whether rules should be followed in a rigid manner or are subject to exception.[83] In other words, there is now a diagnostic that measures our feelings about rules and our propensity to rationalize rule breaking—essentially, what a person's threshold to unethical or illegal behavior might be.[84] While companies must be careful how they collect and use diagnostic information, these assessments offer a baseline of individual behavioral ethics risk, a critical compliance metric under this new GRC paradigm.[85]

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[80] *See* Kelly Richmond Pope, *Measuring the Ethical Propensity of Accounting Students: Mach IV Versus DIT*, 3 J. ACAD. ETHICS 89, 89-90 (2005).

[81] *Id*. at 90.

[82] *See* Adam Fine, et al., *Rule Orientation and Behavior: Development and Validation of a Scale Measuring Individual Acceptance of Rule Violation*, 22 PSYCHOL. PUB. POL'Y & LAW 314, 323 (2016).

[83] *Id*.

[84] *Id*. at 315.

[85] *See* FELDMAN, *supra* note [ ], at 136 (describing Walmart's use of screening test for new hires that predicts discriminatory behavior).

Early stage employees can be assessed for ethical decision making in other ways. For example, Goldman Sachs invites its analyst interns seeking full-time employment to attend a rigorous training and orientation program.[86] Goldman personnel warn the analysts repeatedly that cheating on skills tests is not tolerated. In one test, which is not particularly difficult, interns are told they cannot conduct outside research, yet are given access to computers with Internet connections. Recently, Goldman dismissed twenty interns from the program for Googling answers, which was intentionally monitored by the firm.[87] The true test was whether an intern could make an ethical decision in a highly competitive environment. Dismissing the violators not only eliminated future conduct risk emanating from the rule violators, but it also helps to build a culture of honesty by signaling firm values.[88]

B. Identifying and Monitoring Employees Posing Heightened Behavioral Ethics Risk

Once an employee joins a company, efforts can be directed at identifying and monitoring problematic ethical decision making. Companies should start by identifying those individuals in the company's network who possess outsized ethical influence. These are the employees that by virtue of their position in the company's social or organizational hierarchy are "connectors"—those "prolific few who tie an entire . . . [organizational] network together."[89] As explained above, these employees have the ability to generate significant conduct risk and spread it throughout the firm.[90]

How are these employees identified? The company's organizational chart is a useful starting point because it provides a sense of professional reach, but it only goes so far in showing ethical influence. For example, as seen with the recent Wells Fargo fake accounts scandal, the CEO was not the origin or driver of the

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[86] Julia La Roche, *This Is How the Goldman Sachs Analysts Who Got Fired Were Cheating*, BUS. INSIDER, Oct. 19, 2015, http://www.businessinsider.com/goldman-sachs-analysts-fired-for-cheating-2015-10.

[87] *Id*.

[88] *See* John C. Hollwitz & Donna R. Pawlowski, *The Development of a Structured Ethical Integrity Interview for Pre-Employment Screening*, 34 J. BUS. COMM. 203, 214-16 (1997). (outlining procedures for structured pre-employment ethics interviews).

[89] BUCHANAN, *supra* note [ ], at 114.

[90] Gino, Ayal & Ariely, *supra* note [ ], at 397.

unethical behavior.[91] The true influencers at the bank were a few regional managers connected to the head of the community banking division; they were the "hubs" of the network through which behavioral compliance risk spread.[92] Accordingly, compliance personnel need to identify those in the company who are the true catalysts of potentially unethical behavior. While most of the rhetoric regarding corporate culture focuses on "tone at the top," that may not be where the most significant behavioral ethics risk lies.[93]

After it is determined who in the organization is an ethical influencer, they should be assessed for individual behavioral compliance risk. The diagnostic tools discussed earlier would provide one data point, but assessing risk is dynamic and multifaceted. Fortunately, conducting risk assessments as part of the GRC function is familiar to most companies.[94] However, companies must keep in mind that they are trying to identify ethical decision making risk, not the more familiar business process and enterprise risk.[95]

One company taking the correct approach is Morgan Stanley, who now asks its risk and compliance officers to evaluate "material

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[91] *See* SALES PRACTICES INVESTIGATION REPORT, INDEPENDENT DIRECTORS OF THE BOARD OF WELLS FARGO & COMPANY 50 (Apr. 10, 2017), https://www08.wellsfargomedia.com/assets/pdf/about/investor-relations/presentations/2017/board-report.pdf. This is true of a number of corporate scandals. *See e.g.*, Peter Evans, *How Much Could the 1MDB Scandal Cost Goldman Sachs?*, N.Y. TIMES (Dec. 9, 2018) (indicating bribery scandal likely localized to a few, powerful players within the bank tied to a single Malaysian financer).

[92] MARK BUCHANAN, NEXUS: SMALL WORLDS AND THE GROUNDBREAKING SCIENCE OF NETWORKS 85 (2002).

[93] *See, e.g.*, Hon. Patti B. Smith, Chair, U.S. Sentencing Comm'n, Remarks at the Twelfth Annual Compliance and Ethics Inst. (Oct. 7, 2013) ("[T]he guidelines emphasize the importance of a 'tone from the top' and the need for internal corporate monitoring and auditing as a means of deterring organizational crime."); Benjamin van Rooij & Adam Fine, *Toxic Corporate Culture: Assessing Organizational Processes of Deviancy*, 8 ADMIN. SCI. [1], [27] (2018) ("Toxic culture is not just a matter of one bad CEO, one bad sent of incentives, or the tone at the top. Certainly, the fish can rot from the head, but that certainly is not the only way it rots.").

[94] Robert C. Bird & Stephan Kim Park, *Turning Corporate Compliance into Competitive Advantage*, 19 U. PENN. J. BUS. L. 285 (2017).

[95] For a good discussion of corporate approaches to identifying legal, regulatory, and compliance risk, see generally, *ibid*.

risk-takers."[96] For example, a trader that frequently hits trading limits, misses compliance trainings, or fails to take mandatory holidays imposed to uncover fraud would raise concern. Once identified, such an employ would be monitored for risk-taking behavior, and how they managed it would factor into promotion and compensation decisions. This could lead to bonus reductions or even termination for cause.[97]

Ideally, however, a behavioral risk evaluation would consider many other factors that impact ethical decision making, and do so more prospectively. Behavioral ethics research has demonstrated that factors related to stress and depleted mental resources cause ethical decision making shortcuts, so assessments should consider if employees are under such strain—caused either by personal issues or company pressures.[98] Another evaluative tool is to identify employees who regularly rationalize. While this may be more difficult to objectively monitor, one way to assess the propensity to rationalize is to hold employee roundtables in which rule breaking and ethical dilemmas are discussed. Fairly quickly, employees will offer a host of rationalizations justifying various behaviors. Parsons, an international engineering company, hosts an internal website where it poses hypothetical ethics problems and asks employees to vote on how they should be resolved; the responses indicate what rationalizations are being employed by individuals and groups.[99] Finally, although counterintuitive, employees engaged in creative tasks are at heightened ethical risk.[100] Compliance personnel should assess business units and job categories where creativity is expected and add that to the behavioral risk assessment schedule. Specific behavioral risk factors will vary depending on an individual's place in an industry, a company, a business unit, and a sub-group—and

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[96] Olivia Oran, *Wells Fargo Scandal Reignites Debate about Big Bank Culture*, REUTERS, Sept. 28, 2016, https://www.reuters.com/article/us-wells-fargo-accounts-culture-analysis/wells-fargo-scandal-reignites-debate-about-big-bank-culture-idUSKCN11Y1S1.

[97] *Id.*

[98] *See* Francesca Gino, et al., *Unable to Resist Temptations: How Self-Control Depletion Promotes Unethical Behavior*, 115 ORG. BEHAVIOR & HUMAN DEC. MAKING PROCESSES 191 (2001). This, of course, requires companies to be introspective and honest about the pressures and incentives it is placing on employees.

[99] *See* Scott Killingsworth, *Modeling the Message: Communicating Compliance through Organizational Values and Culture*, 25 GEO. J. LEGAL ETHICS 983 (2012).

[100] Francesca Gino & Dan Ariely, *The Dark Side of Creativity: Original Thinkers Can Be More Dishonest*, 102 J. PERSONALITY & SOC. PSYCHOL. 445 (2012).

will change over time—but thoughtful compliance professionals should be able to craft a behavioral risk matrix that considers many of these factors.[101]

For the employees who do exhibit heightened behavioral ethics risk, and even more so for those that are also ethical influencers, the company should allocate disproportionate compliance resources toward them. Such employees should receive more training, more monitoring, and be subject to more investigative inquiries. Put bluntly, compliance officers should be on a first-name basis with these employees. In addition, compliance tools should be tailored to these high-risk employees. Although it is framed as a management practice, global equipment and engineering consulting firm Barry-Wehmiller provides individualized ethics and compliance programing to its employees.[102] The company's CEO meets with each employee to understand their values, interests, goals, and personal and professional challenges. Employees are then slotted into an appropriate level of the firm's ethical leadership training curriculum.[103]

C. Mitigating Behavioral Ethics Risk

Regardless of an employee's ethical risk profile, every company's compliance program should be looking for opportunities to increase the ethical decision making and behavior of its employees, officers, and directors. While most companies' programs attempt to educate and train employees on legal doctrines and company rules, this ignores the System 1 process that dominates ethical decision making. It is simply unrealistic to expect employees to memorize a litany of complex rules, identify when those rules apply in complex and fast moving factual situations, and then harness their reflective thinking system to properly follow them. Not to mention also guarding against System 2 motivated reasoning.

A more fruitful approach is to aim compliance interventions at the inflection points where decision making becomes behavior. Not

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[101] *See* ROGER MILES, CONDUCT RISK MANAGEMENT: USING A BEHAVIORAL APPROACH TO PROTECT YOUR BOARD AND FINANCIAL SERVICES BUSINESS 37, 161 (2015) (explaining reference points that inform risk profile and listing five factors that increase conduct risk).

[102] *See* BOB CHAPMAN & RAJ SISODIA, EVERYBODY MATTERS: THE EXTRAORDINARY POWER OF CARING FOR YOUR PEOPLE LIKE FAMILY 213-23 (2015) (explaining company's employee-centered approach to business).

[103] *Id.*

only is this approach more consistent with behavioral theory, it recognizes the practicalities of "what actually happens" with employee thinking.[104] The idea is that companies must "frame [their] training around . . . specific, risky job tasks" to ensure unethical employee decision making is properly targeted.[105] Doing otherwise "pushes all of the 'transfer' work to the employee," and transfer is the critical step in the application of learned knowledge.[106]

For example, Broadcat, a start-up compliance provider, uses a series of checklists for its clients that are task specific and direct employee action. One called "Going Oversees On a Business Trip?" contains check boxes for things such as getting company preapprovals for gifts and entertainment, securing computer files before travel, and carrying an ethics helpline phone number.[107] Although the checklist is simple and easy to understand, it is grounded in sophisticated behavioral science—it is a "precommitment device" for avoiding conduct risk. By committing to the company's antibribery provisions, and then being reminded of them while undertaking the task of oversees travel, employees are less likely to engage in risk-creating behavior when the temptation is highest.

A host of these types of "behavioral ethics nudges" are available to be integrated into existing compliance programs.[108] Probably the most ubiquitous example is asking employees to read and affirm an ethics-focused certification before they engage in behavior that poses compliance risk, *e.g.*, filling out expense reports, transferring client funds, or meeting with government officials. Studies show that reminding employees of morality before they act reduces dishonesty, likely because it prompts deeper System 2 reflection regarding the ethics surrounding the task.[109] This type of "just-in-time" compliance nudge was first used in the insurance business, but is now considered standard practice in many companies. International

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[104] MILES, *supra* note [ ], at 63.

[105] Ricardo Pellefone, *Keeping Compliance Simple*, http://www.thebroadcat.com/downloads.

[106] *Id*. *See also*, SUSAN AMBROSE, ET AL., HOW LEARNING WORKS: 7 RESEARCH-BASED PRINCIPLES FOR SMART TEACHING (2010).

[107] *Id*.

[108] Haugh, *Nudging*, *supra* note [ ], at 710-15 (discussing a number of nudges being used in business to increase employee ethicality).

[109] *See* DAN ARIELY, THE HONEST TRUTH ABOUT DISHONESTY 39–53 (2012) (explaining the impact of asking participants to recall moral standard before engaging in behavior).

Paper uses a similar strategy; instead of certifications, though, the company provides all employees with a wallet card containing ethics-related questions.[110] As employees consider business decisions, they will be reminded of the questions and more fully contemplate their ethical obligations.

Companies may also consider using more sophisticated behavioral strategies. JPMorgan uses proprietary software to monitor the email and telephone communications of its traders to ensure they "adhere to 'personal trading rules' and risk limits."[111] While this type of monitoring has been part of corporate compliance and risk management for years, JPMorgan's efforts are noteworthy because the bank's software algorithms attempt to predict unethical or illegal trading behavior and stop it before it occurs. Such "predictive monitoring" uses a series of alerts to nudge traders, and alert compliance staff, if they are about to violate a company or legal rule.[112]

Finally, not all behavioral ethics risk management strategies are aimed at intervening to stop unethical behavior; just as important is fostering ethical acts. Research shows that compliance messaging is more effective when it demonstrates that ethical behaviors are widely engaged in and supported.[113] The reason is likely related to how individuals rationalize their conduct. Positive compliance messaging of this type combats the notion that ethical decision making is an isolated act, therefore to commit bad behavior is somehow normal.[114] That means companies need to share genuine stories of their ethics and compliance successes, conveying the message that the majority of the company is committed to making

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[110] Francesca Gino, Lisa D. Ordonez & David Welsh, *How Unethical Behavior Becomes Habit*, HARV. BUS. REV., Sept. 4, 2014, https://hbr.org/2014/09/how-unethical-behavior-becomes-habit.

[111] Portia Crowe, *JP Morgan Is Working on a New Employee Surveillance Program*, BUS. INSIDER, Apr. 8, 2015, http://www.businessinsider.com/jpmorgans-employee-surveillance-program-2015-4.

[112] Hugh Son, J*PMorgan Algorithm Knows You're a Rogue Employee Before You Do*, BLOOMBERG, Apr. 5, 2015, http://www.bloomberg.com/news/articles/2015-04-08/jpmorgan-algorithm-knows-you-re-a-rogue-employee-before-you-do.

[113] *See* Robert B. Cialdini, et al., *Managing Social Norms for Persuasive Impact*, 1 SOC. INFLUENCE 3, 11-12 (2006); Lynn S. Paine, *Managing for Organizational Integrity*, 72 HARV. BUS. REV. 106, 111 (1994) (explaining that "[e]mployees may rebel against programs that stress penalties" and view compliance programs that do not address root causes of misconduct skeptically).

[114] *See* JAMES WILLIAM COLEMAN, THE CRIMINAL ELITE 197 (5th ed. 2002) (describing the claim of relative acceptability/normality rationalization).

ethical decisions.

One way to do so that takes advantage of network theory is to leverage ethical employees who are hubs of influence as "compliance ambassadors." This can take many forms. One is that these employees can be asked to identify gaps in compliance and "bring those issues back to HQ, with suggestions on how to fix them."[115] This not only helps compliance officers who cannot anticipate every possible compliance risk, but it also strengthens in-group ethical behavior.[116] Another behavioral focused approach is to ask these ambassadors to simply talk about ethics and compliance with their co-workers, including temptations and pressures that may cause ethical decision making lapses. When System 1 biases and heuristics or System 2 rationalizations arise, they should be drawn out and explored. The goal is for the ambassador, possibly with the help of compliance personnel, to raise "conscious awareness [of] certain patterns of self-exculpatory reasoning, and to flag them as suspicious."[117] That way, employees will be less likely to use bounded ethical decision making in the future.

CONCLUSION

The goal of this Essay has been to outline key insights from research in behavioral ethics, criminology, and network theory to provide a new paradigm through which to harmonize corporate governance, risk management, and compliance. By focusing on the core driver of compliance failures, individual unethical decision making, the GRC functions at companies can be better understood and improved upon. A behavioral ethics risk management approach is best positioned to achieve the overarching goal of all companies' GRC efforts—the reduction of conduct risk to allow for more efficient and effective business operation.

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[115] Richard Bistrong, *Are Your Sales Teams Compliance Ambassadors?*, FCPABLOG, Feb. 24, 2016, http://www.fcpablog.com/blog/2016/2/24/richard-bistrong-are-your-sales-teams-compliance-ambassadors.html.

[116] Linda Klebe Trevino, et al., *(Un)ethical Behavior in Organizations*, 65 ANN. R. PSYCHOL. 635, 643 (2014); Gino, Ayal & Ariely, *supra* note [ ], at 393.

[117] Joseph Heath, *Business Ethics and Moral Motivation: A Criminological Perspective*, 83 J. BUS. ETHICS 595, 611 (2008).