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Banking on team ethics : a team climate perspective on root causes of misconduct in financial services

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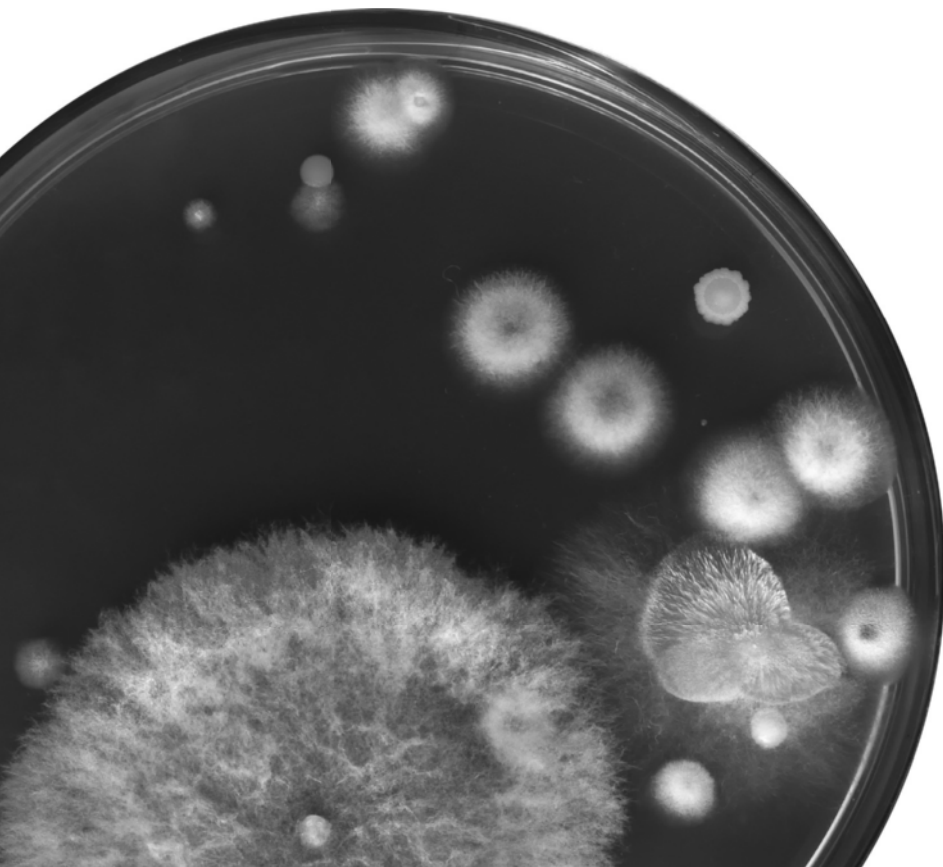
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Introduction



Introduction

The personal story of Kweku Adoboli, the British trader who was convicted in 2012 for losing \$2.3bn of the Swiss bank UBS, was published in the fall of 2015 by the Financial Times¹. This 'rogue trader's tale' is one of few insider's views gone public of a trader that committed fraud. Adoboli, working in the investment bank's global synthetic equities division, spent nearly four years in prison for exceeding his risk limits and hiding this by booking fictitious hedging trades. He also created a sort of internal fund filled with skimmed profits, that he could use to cover up daily losses. For years, using these methods, he made millions for the bank. In 2010 he was promoted to director and was rewarded by a £250,000 bonus (although Adoboli never received this bonus), on top of his £110,000 salary at that time.

His UBS colleagues, the article says, claim that they had no idea that he was committing fraud. Adoboli maintains that management pushed him to make as much money as he could for the bank and even used him as an example for others when he was doing well. He helped his colleagues when there were problems. A former UBS trader told the author of the FT article that Adoboli was the man to turn to if you had screwed up. He would fix it for you, and "We didn't know how he did it, but we didn't want to know". In line with this statement, Adoboli says that "others did in fact know, and actively encouraged his behaviour for more than two years as long as it was profitable".

Adoboli was convicted when he was 31 years old, and condemned by the public, being the perfect mascot of The City's 'greedy' and misbehaving bankers, when the public trust in banking reached an ultimate low. UBS, his management or his teammates were not held accountable for anything that might have contributed to Adoboli acting like he did. The bank is off the hook. According to Adoboli - as stated in the article - "by holding up himself and Tom Hayes, the former UBS and Citigroup derivatives trader who was jailed ... for manipulating Libor, as rotten apples in otherwise a clean industry, the banks are moving on without considering what happened to allow or even encourage their misconduct".

Now, what caused Adoboli to commit fraud cannot be fully derived from public information released in this FT article alone. What does seem valid, even without having conducted further analysis, is that there is more to his story than merely the individual motivation to make money, or a personal willingness to cross limits and break the rules in doing so. The targets and praise Adoboli received from his management, the calls for aid from his teammates and the fact that others chose not to ask questions, all influenced the way he acted. Adoboli did commit fraud and punishment is justified. Nevertheless, without taking away his individual responsibility and accountability, I argue that punishing Adoboli alone is not enough to prevent future misconduct cases in his or other trading teams within banking. The professional context in which he worked

¹ Financial Times, October 22, 2015. "Kweku Adoboli: a rogue trader's tale". Available at: <http://www.ft.com/intl/cms/s/2/0fa0b42a-783a-11e5-a95a-27d368e1ddf7.html>

harbours root causes of his misconduct. As long as these contextual root causes are not identified and dealt with, the chance that a misconduct case like this occurs in the future is considerable.

In this book I address contextual root causes of misconduct from a social psychological perspective. My central argument is that shared behavioural patterns reflecting the climate within a trading team can contribute to the (mis-)behaviour of its individual members. Social psychology works from the assumption that our behaviour at work is influenced by our direct social context: our colleagues, our manager and the team we work in. Identifying social psychological root causes of misconduct implies addressing team climate and behavioural patterns as potential contributors to the choices made by individual workers. The bad news of such an analysis is that getting rid of specific individuals who committed fraud (as 'rotten apples') is unlikely to eliminate such contextual root causes of misconduct. The good news is that these root causes represent concrete levers banking divisions can analyse and use to prevent future misconduct cases. Finding contextual root causes, and using social psychological knowledge to prevent future misconduct cases within trading businesses, is the next step that banks and financial supervisors can use to improve the industry. My analysis aims to identify such contextual root causes, invoking current insights from empirical research in psychology, as a way to deliver practical guidelines for banks and financial supervisors that help to prevent future misconduct.

Overview

In this book, I present my analysis in four parts. First, Part I introduces the preventive social psychological approach to misconduct within trading teams. It shows that misconduct is a current and continuous problem within banking, and explores its detrimental consequences (Chapter 1). It clarifies my conceptualisation of misconduct, and explains the context of my analysis. When examining relevant contextual variables, I distinguish between (a) the context of financial supervision, that provided the data for this research and (b) the context of trading businesses within banking and three organizational aspects that characterize this professional context (Chapter 2). I elaborate on the central problem presented here: banks and financial supervisors are insufficiently effective in preventing future misconduct. My approach to addressing this central problem is to introduce the Corrupting Barrels model, based on an overview of social psychological root causes of misconduct that offers an approach to effectively prevent future misconduct (Chapter 3).

In Part II, I discuss current banking and financial supervisory practices as outcomes of my analysis conducted in the context of my (former) job in financial supervision. Chapter 4 first offers an overview of two studies and their different research questions and data sources. Then, I present a first study that explores to what extent banks currently include team level in their own analysis of misconduct cases when this is initiated by themselves (Chapter 5 on Study 1). Next, in a second study, I explore the effects of initial supervisory requests asking banks to analyse their misconduct cases and to include the team level in their analyses (Chapter 6 on Study 2).

In Part III, I present a supervisory assessment of social psychological root causes of misconduct within trading teams (Study 3), using the Corrupting Barrels model that I developed as a basis. After introducing the research question and data source (Chapter 7), I first elaborate on the theoretical foundation of the Corrupting Barrels model by providing an overview of the scientific research on three social psychological root causes of misconduct (Chapter 8). I summarize research on error management, relating to the task of the team and the way errors relating to that task are dealt with. An ineffective error approach within a team can form a root cause of misconduct (paragraph 8.1.). Next, I review research on outcome inequality, relating this to the relationships within the team. This inequality, and its emotional consequences such as perceived injustice and envy, can form a root cause for misconduct (paragraph 8.2.). I connect to prior research on morality, relating this to the moral climate within a team. A dysfunctional moral climate can form a root cause for misconduct (paragraph 8.3.). Furthermore, I elaborate on leadership impacting team climates Paragraph 8.4). Finally, I describe Study 3: a supervisory assessment of social psychological root causes of misconduct within trading teams (Chapter 9, on Study 3) and present the outcome of this analysis in the form of a framework (including deskresearch guidance, formats for interviews and observations and a survey) that can be used to identify team climates facilitating misconduct.

In Part IV, I present the conclusions of my analyses and explore the practical implications of the preventive approach of misconduct that can be used by banks and by financial supervisors (Chapter 10). I discuss the way banks and supervisors can use the Corrupting Barrels model and framework to *analyse* the root causes of misconduct (paragraph 10.1). Next, I discuss the way team climates facilitating misconduct can be *improved* using the insights as presented (paragraph 10.2). Finally, in Chapter 11, I consider the strengths and limitations of my analysis and offer suggestions for future research.

