



Universiteit
Leiden
The Netherlands

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

Scholten, W.W.

Citation

Scholten, W. W. (2018, March 29). *Banking on team ethics : a team climate perspective on root causes of misconduct in financial services*. *Dissertatiereeks, Kurt Lewin Institute*. Retrieved from <https://hdl.handle.net/1887/61392>

Version: Not Applicable (or Unknown)

License: [Licence agreement concerning inclusion of doctoral thesis in the Institutional Repository of the University of Leiden](#)

Downloaded from: <https://hdl.handle.net/1887/61392>

Note: To cite this publication please use the final published version (if applicable).

Cover Page



Universiteit Leiden



The handle <http://hdl.handle.net/1887/61392> holds various files of this Leiden University dissertation

Author: Scholten, Wieke

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

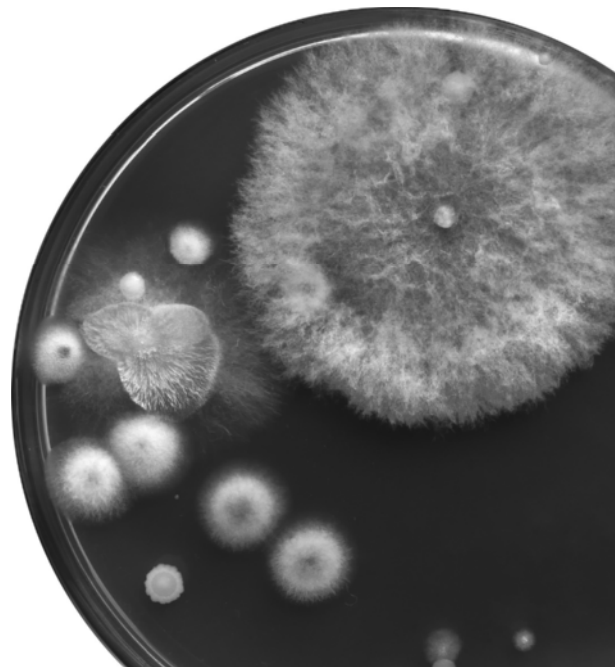
Date: 2018-03-29

Part II

Banking and supervisory practices

Chapter 5

Study 1. Current banking practices: teams are the blind spot



Chapter 5

Study 1. Current banking practices: teams are the blind spot

1. A banks' litigation report

Bank A produced a litigation report in the year 2015, that summarizes all misconduct cases that were known to the bank and defined as legal matters at that point in time. The litigation report was written by the bank's legal and control unit, and was meant to inform senior management on all current litigation cases and their status update. As part of a behaviour and culture supervisory assessment, the report was studied as desk research material.

1.1. Research question

The following research question was central to the analysis of the litigation report.

Research question

1. To what extent do banks consider team climate in their own reporting of misconduct cases?

1.2. Approach

To answer this research question, I read the litigation report thoroughly and analysed the quantitative and qualitative data the report offers. I focused on:

- a. The root causes reported in analyzing the misconduct cases;
- b. The response to the misconduct cases of bank A.

1.3. Results

General results

The litigation report states over 5000 legal matters known in 2015 within bank A – as explained in Chapter 4, a bank with more than 50.000 employees worldwide. Of those more than 5000 matters, 18 misconduct cases make up most of the legal risk bank A is facing at that point in time. The litigation report focuses for that reason on these 18 misconduct cases, of which 78% occurred within the investment banking division of the bank. The fact that most of the highest risk matters are concentrated within investment banking, is in line with the rationale underlying the focus of my analysis on trading businesses as elaborated on in Chapter 2.

Root causes

The litigation report lists 14 outcomes of the incident analysis bank A had conducted on its 18 misconduct cases. The list of 14 outcomes is provided in Table 5, in the exact order as reported by bank A in the litigation report.

A root cause analysis of misconduct cases generally aims to answer the question what caused the misconduct, or unethical behaviour that occurred. Study 1 aims to identify whether or how team level factors are taken into account by the bank itself as potential root causes of misbehaviour. Here I distinguish two levels of root causes of misconduct, illustrated in Figure 5.1:

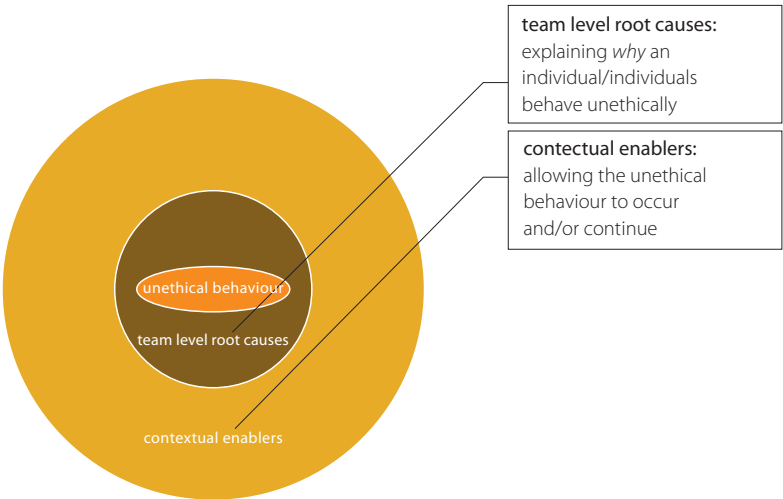
1. Level 1: why did an individual or multiple individuals behave unethically?

This level of root causes explains what caused the individuals involved to behave unethically by considering a social psychological perspective. From this perspective team climate is a relevant context that may contribute to answering this question. Any root cause that refers to error climate indicators, indicators of negative emotional consequences of outcome inequality, or moral climate indicators thus may indicate that team climate may have influenced individual behaviour.

2. Level 2: what allowed the unethical behaviour to occur and/or to continue?

This level of root causes refers to circumstances or context variables that gave the opportunity to behave unethically, and/or that allowed the unethical behaviour to continue. Contextual enablers at this level could relate to culture elements, such as a culture of not speaking up or a lack of clear guidance or oversight by local management. Other examples could be enablers that refer to failing controls, such as ineffective processes, systems or structures that are too complex to detect unethical behaviour in time or at all. These contextual enablers cannot explain what caused the misconduct, but can explain why the misconduct emerged and/or was not quickly addressed. Also, the presence of controls can be a guidance for employees, showing them what aspects of their work they should attend to or prioritize. Likewise, when breaching a norm leads to consequences, these consequences could be a deterrent to misconduct. Failure of controls could therefore be, next to an enabler, an indirect cause of misconduct.

Figure 5.1. Two levels of root causes of misconduct



When considering the 14 outcomes of the incident analysis listed in the report, three categories emerge. The first and largest category of outcomes (first green column of Table 5.1, corresponding with the red heart of Figure 5.1) do not consider root causes of misconduct in the sense as indicated above. This category contains 9 outcomes that only describe the actual misconduct itself. This majority of the outcomes of the incident analysis conducted by bank A thus describe what happened, detail the behaviour that was shown in the cases, but make no attempt to explain why this behaviour occurred (in the sense of the 'team level root causes' indicated in the middle ring of Figure 5.1) or *what allowed* the unethical behaviour to occur and/or continue (represented as 'contextual enablers' in the outer ring of Figure 5.1). Examples of outcomes or mere descriptions of unethical behaviour, are 'unprofessional communications in chat rooms and mail', 'misselling' and 'violations of embargoes'.

Table 5.1. Outcomes of the analysis of relevant misconduct incidents, as reported in the litigation report of bank A

Outcomes of the incident analysis in reported order	Classification		
	Unethical behaviour: description of the actual misconduct itself	Contextual enablers: allowing the unethical behaviour to occur and/or continue	Team level root causes: explaining why an individual / individuals behave unethically
	9 of 14 reported outcomes	4 of 14 reported outcomes	1 of 14 reported outcomes
1. Unprofessional communications in chatrooms and mail	X		
2. Improper benchmark submissions	X		
3. Improper inducements to obtain business	X		
4. Violations of embargoes	X		
5. Market manipulation	X		
6. Misselling	X		
7. Valuation issues	X		
8. Transaction lacking economic substance	X		
9. Tax driven transactions	X		
10. Conflict of interest			X
11. Insufficient risk disclosure		X	
12. Inadequate systems and controls		X	
13. Complex structure and insufficient controls		X	
14. Other: KnowYourClient issues, criminal conduct, antitrust violation...	(X)	X	

Next, the second largest category of outcomes of the incident analysis (second green column of Table 5.1, outer ring of Figure 5.1) indicate root causes at the contextual level. This category contains four contextual enablers that relate to the question of what allowed the misconduct to occur and/or continue. Examples in this category are 'inadequate systems and controls' and 'complex structure and insufficient controls'. 'Insufficient risk disclosure' refers to the extent to which the business where the misconduct occurred was reporting the risks the business was facing, and/or the extent to which the risk management, compliance and audit functions assessed the relevant risks. This risk assessment often determines the level and intensity of controls.

For outcome number 14 'Other', is an accumulation of analytical outcomes. Three relevant aspects of the incident are explicitly mentioned under 'other', namely: 'Know Your Client (KYC) issues', 'criminal conduct' and 'antitrust violations'. The last two— 'criminal conduct' and 'antitrust violations' - actually describe the misconduct itself - not what caused it. These can be classified in the first category of outcomes: descriptions of unethical behaviour. 'KYC issues' refer to issues related to the Know Your Client regulation banks have to consider when getting into business with new clients. The KYC regulations ask of a bank to know its clients and to know the origin of its capital. This prevents the bank from doing business with corrupt parties for instance. Failing to comply with 'KYC' regulation issues' can make way for clients and bank employees to behave unethically, this refers to a contextual enabler, and hence is classified in the third column of Table 5.1 (corresponding to the, outer ring of Figure 5.1).

Finally, and most importantly considering the research question: the third green column of Table 5.1 indicates mention of actual root causes at team level (indicated in the middle ring of Figure 5.1). Only 1 of the 14 outcomes of bank A's incident analysis, actually addresses such a root cause as a potential reason why an individual / individuals behaved unethically. The 'Conflict of interest' that is mentioned here could explain *why* an individual or individuals commit fraud. When an individual serves in different roles with conflicting stakes and interests, this can induce conflicting motives, lack of transparency and opportunistic decision making. This is the only incident analysis that can be classified as referring to a team level root cause.

In sum, the internal litigation report offers an account of different instances of fraudulent behaviour (9 out of 14 incident analyses), some ideas on what *allowed* this behaviour to occur and/or continue (4 out of 14 incident analyses), and very few ideas on what *actually caused* the unethical behaviour (1 out of 14 incident analyses). These numbers indicate that bank A does not systematically address the team climate, or culture at working floor level, in analysing potential causes of key misconduct cases.

While I categorized the 14 outcomes of the incident analysis into these three categories, the report does not refer to such a classification. The report does not distinguish between outcomes that explain why an individual behaved unethically, outcomes that explain what allowed the misconduct to occur or continue, and outcomes that merely offer a more concrete description of the unethical behaviour that was shown. In just listing 14 different analysis outcomes for the 18 incidents examined, the report shows little understanding of and exemplifies little need to understand what actually caused the unethical behaviour.

Finally, to learn why the misconduct occurred more insight is required about relevant day-to-day realities on the working floor where the misconduct took place. Any information on this working floor reality, the climate in the teams involved, during the period before the misconduct occurred is essential to determine the circumstances that led up to the incident that occurred. However such pre-incident information is completely missing from this report.

Response

The litigation report also lists five categories of responses to misconduct. These five response categories, or post-incident actions as the report titled them, are reproduced in Table 5.2. Unfortunately, it is not indicated in the report how many actions were taken per category.

Table 5.2. *Categories of post-incident actions*

	Categories of post-incident actions
1	Internal investigation
2	Remediation efforts (e.g. suspending business, systems and controls)
3	Disciplinary / employment measures (firing, suspending)
4	Regulatory interactions / antitrust and/or criminal investigations
5	Civil litigation

Only the first category of post-incident actions, internal investigations (category 1), is potentially (partly) aimed at revealing root causes within team climates. These internal investigations in principle have the potential to reveal social psychological mechanisms at team level, that facilitated unethical behaviour. Again, the post-incident action category of internal investigations is first in line in the reported list of post-incident action categories. This order as chosen by bank A suggests that internal investigation is a frequent response to misconduct and of the highest priority. The litigation report does not show how many of the 18 cases have been investigated internally. It therefore is possible that all cases have been investigated internally. However, bank A has disclosed the results of an internal investigation of only one of the 18 cases, next to the litigation report. This in-depth investigation aimed to identify the circumstances that led up to the misconduct happening. This specific internal investigation, of a single misconduct case, is further analysed in paragraph 2 of this Chapter. Bank A only disclosed one internal investigation to the supervisory team of behaviour and culture, which was offered as the best example of an internal investigation that explores the root causes for the misconduct broadly, including culture related aspects.

Four out of five categories of post-incident actions, are in line with the three-way common banking response to misconduct as described in Chapter 3:

- a. Containment of the misconduct and a focus on damage control: categories 4 and 5.
- b. Taking disciplinary measures against the 'bad apples', the traders involved: category 3.
- c. Increasing controls aimed at decreasing the opportunity for 'bad apples' to cross the line: category 2.

These actions reveal that bank A aims at *containment* of the misconduct and its financial, legal or reputational consequences. Examples are the post-incident actions relating to civil litigation (category 5), interaction with the regulator and criminal investigations (category 4). Containment of misconduct cases is aimed at damage control and closing cases. Second, disciplinary or employment measures as a response to misconduct (category 3) are listed by the litigation report. Clearly, these measures are often just and called for. When an employee behaves unethically and breaks the law doing so, a bank often inevitably ends his or her employment. However, when these disciplinary or employment measures are not combined with investigations into team climate and social psychological root causes of the unethical behaviour shown, this signifies a '*bad apple*' perspective and '*blame and punish*' approach of the bank. Third, the remediation efforts (category 2) of suspending the business after misconduct occurred in a particular business, and *increasing controls*, is aimed at decreasing the opportunity for individuals to behave unethically again.

Responses to misconduct focused on containment efforts, disciplinary measures and remediation efforts inhibit bank A's ability to learn from prior misconduct cases by analysing broader circumstances such as team climate. These post-incident actions do not reveal a concern for team level root causes of unethical behaviour shown in these cases. Even the supervisory team that was responsible for the root cause investigation of bank A's misconduct cases showed signs of containment. This is illustrated by their reluctance to be transparent about the litigation report as I will explain below. For me as a senior supervisor of behaviour and culture, with the explicit temporary assignment to assess culture and misconduct related issues at bank A, it was hard to get access to the relevant information. My supervisory colleagues at the bank were hesitant about sharing information because of its 'sensitive' nature. I could only access information on a 'need to know basis', resulting in a need for me to make a strong case for analysing the litigation report and related information. After making this strong case, I was allowed by the supervisory team to study the report one day, at their premises. I was not allowed to receive a softcopy of the report through a secured email line, nor was I allowed to make a hard copy of the report. So, I made extensive notes and copied relevant information while I was there. One of the supervisors even got irritated and said: "*What kind of analysis would you like to see of bank A? How much would that analysis cost them?*". With his intonation, he made perfectly clear that he thought it was unrealistic to ask of a bank to do a root cause analysis at team climate level of their misconduct cases. Even if these misconduct cases were numerous and had potentially severe consequences.

1.4. Conclusions

Bank A does not consider the team climate perspective in its own analysis of misconduct cases. Hardly any incident analyses of and responses to misconduct as reported by bank A refer to actual root causes of misconduct at all. Team climate, although it can harbour social psychological root causes of unethical behaviour, is a blind spot for bank A.

The post-incident actions, or responses, of bank A to its misconduct might further explain this blind spot for team climate aspects facilitating misconduct. Bank A's responses to misconduct are mainly focused on *containment* efforts, *disciplinary measures* and *remediation* efforts. These responses inhibit bank A's ability to learn from its misconduct cases by analysing team climate and do not reveal team climate root causes of unethical behaviour shown in these cases. Even the supervisory team dedicated to supervise bank A showed signs of containment by making the report and related data nearly inaccessible to supervisory experts of behaviour and culture who were involved in supervising bank A's culture issues. This containment response impedes the potential of analysing the root causes of the misconduct cases in depth, and has therefore a detrimental impact on preventing future misconduct within investment banking of bank A.

To prevent misconduct it is essential that banks, and supervisors alike, analyse misconduct that has occurred in depth to see what *caused* the misconduct to occur (and adopt a team level perspective in doing so). Due to bank A's disclosure of an internal investigation of only one of the 18 cases included in the litigation report I cannot exclude the possibility that only 1 case of 18 highest risk matters that were addressed was investigated in depth by bank A. The next paragraph, 2, analyzes the minutes made during this investigation of a single case, to reveal whether and to what extent bank A did include the team climate perspective in this single case investigation.

2. A bank's internal investigation

Within its investment banking and trading activities, bank A discovered a misconduct case involving a fraudulent trading scheme with money laundering characteristics. Bank A investigated this misconduct case within its own investment banking division, by conducting an internal audit examination that included interviewing individuals involved. As part of a supervisory assessment of behaviour and culture, the interview minutes were analysed as the output of the bank's internal investigation.

2.1. Research question

The following research question was central to the analysis of the internal investigation report.

Research question

2. To what extent do banks consider team climate in their analysis of a misconduct case?

2.2. Approach

To answer this research question, the approach chosen is a careful analysis of bank A's internal investigation aimed at exploring the root causes of the misconduct case, conducted using 27 semi-structured interviews. To identify to what extent team climate was considered as a relevant root cause during the internal investigation of the misconduct case, the number of words used referring to or relating to team climate during the interviews was counted.

Specifically, for all 27 interview minutes, all words used by the interviewee or the interviewer in the following category were identified as relating to team climate:

- a. All words related to the constructs identified in the 'Corrupting barrels' model, that is, anything related to *error management*, *outcome inequality* and *moral climate* at working floor level within the area where the misconduct had taken place, such as blame experiences leading to fear of repercussions, unequal treatment leading to perceived unfairness or envy and signs of moral neglect.

As the 'Corrupting barrels' model was not yet available at the time, it cannot be expected of internal audit of bank A to have used these specific constructs systematically in their investigation. Therefore, I used a broad definition of team climate references and all words used by the interviewee or the interviewer in the following categories were identified as relating to team climate as well.

- b. Any words on *interactions* at working floor level within the area where the misconduct case had taken place; e.g. statements and perceptions related to exchange of information, consultations and agreements between individual employees or groups of employees such as between the business and control functions.
- c. Any words on *leadership* that was exerted and perceived at working floor level within the area where the misconduct had taken place such as statements and perceptions related to actions, communications, omissions and mindsets of desk heads, middle and senior management.

Box 4 specifies the three classes of team climate indicators that were used during the analysis of the 27 interviews. If a question or an answer contained any words that could be categorised into one of the three categories mentioned, the whole paragraph was identified as 'relating to team climate' and included in the word count – even if the rest of the paragraph was not about team climate per se. By counting the number of words contained in whole paragraphs, and not restricting the count to specific words in sentences or counting separate words, the risk of false negatives (not identifying words on team climate, while during the interview these words were intended to relate to team climate) is mitigated. Because of unclear cut-off points of where the section or statements on team climate ended within a paragraph, whole paragraphs containing words on team climate were included. Therefore, the word count on team climate in my analysis is likely to be *overestimated*, or at least is giving bank A the best possible result in evaluating whether team climate was addressed in the internal investigation.

2.3. Results

Share on team climate

The analysis of the 27 interviews show that in the large majority (23 interviews), no more than 1/3 of the used words by interviewers and interviewees relate to team climate. That is, over

2/3rd of these 23 interviews do *not* address any aspect of behaviour and culture at working floor level that could harbour root causes for the unethical behaviour shown in the misconduct case. Instead, the words used in these interviews address for instance failure of procedures or support systems.

Table 8 shows the average proportion of text in interviews devoted to team climate is 17%. The other 83% of words addressed other aspects related to the misconduct, such as fact checking and failures of procedures or support systems.

82

Box 4. Team climate defined for analysis of bank A's internal investigation interviews

Any words that were used during the interviews – by interviewer or interviewee – referring to day-to-day business and working floor reality. Specifically, words addressing the following team level aspects that may harbour root causes of the unethical behaviour shown in the misconduct case:

1. 'Corrupting barrels' root causes, referring to: error management, outcome inequality, morality. Examples: blame experiences leading to fear of repercussions, unequal treatment leading to perceived unfairness or envy and signs of moral neglect. Examples:
 - "Interviewee said she was very shocked as individual x had always appeared to be very nice, friendly and professional.." (answer)
 - "However interviewee said that there had never been any previous signs of bad behaviour with individual x in terms of incidents reported to him either by Human Resources (HR), Regional Management or (Trading) Business Management." (answer)
2. Interactions between (groups of) employees. Examples: statements and perceptions related to exchange of information and relationships between individual employees or groups of employees, such as between the business and control functions. Examples:
 - "Interviewee described department x as "listening but not helpful in closing gaps", for example leveraging best practices. Interviewee then went on to state that "they have good knowledge in internal policies, but were of no support." (answer)
 - "Interviewee explained that she thought it was a good environment to work in and that everyone (in these other functions) had good professional relationships with each other.." (answer).
 - "Were you ever made aware of tension between group x and other groups at that time?" (question)
3. Leadership aspects. Examples: statements and perceptions related to actions, communications, omissions and mindsets of desk heads, middle and senior management. Examples:
 - "Interviewee also explained that he had an open door policy, though conceded it would have been easier for junior employees to approach him as he knew them better." (answer)

Box 5. Examples of questions and answers not related to team climate.*Questions or answers related to **fact checking**:*

- “Are you familiar with [individual X] efforts to confirm with the bank the validity and purpose of certain transactions w.r.t. the [counterparty Y]?” (*question*)
- “What formal regular meetings did you have with [function B]?” (*question*)

*Questions or answers related to **procedures**:*

- “From what the interviewee has been told, the matter had not been escalated to individual A, but individual B also stated that if the matter could be handled by the team then there would have been no need in his opinion to escalate.” (*answer*)

*Questions or answers related to **support systems**:*

- “Interviewee stated that even when sending a field enquiry within the bank the results were not always good (timely).” (*answer*)
- “The framework is defined from both a Regional and Functional perspective. Coupled with this, the interviewee stated that the bank’s technology is widely recognized across the bank as poor.” (*answer*)

Table 5.3. *Proportion of text in interviews devoted to team climate*

% of text in interview devoted to team climate	No of interviews in this category
< 10 %	9
10-20 %	9
20-30 %	5
>30 %	4
Total average = 17%	Total = 27 interviews

Questions and answers

When broken down into questions asked by the interviewer and answers given by the interviewee, the interviews contain an average of 19 questions and 19 answers per interview. The analysis shows that on average only 2 out of these 19 questions (11%) relate to team climate. This means that on average 17 out of 19 questions (89%) do not relate to team climate, or any aspect of behaviour and culture at working floor level that could harbour root causes for the unethical behaviour shown in the misconduct case. Even though only 2 out of 19 questions on average ask about team climate, twice as many answers are given that relate to team climate. This suggests that even without prompting, interviewees spontaneously mentioned team climate aspects as potentially relevant to the incident analysis. Table 5.4 shows that in average 4 out of 19 answers given (21%) relate to team climate, or any aspect of behaviour and culture at working floor level that could harbour root causes for the unethical behaviour shown in the misconduct case.

Table 5.4. Questions and answers on team climate

	Average No per interview	Average No on team climate per interview
Questions	19	2 (11%)
Answers	19	4 (21%)

Follow-up questions

There are twice as many answers on team climate than questions on team climate. This suggests that interviewees volunteered this information because they thought it was relevant. It also raises concerns on to what extent the interviewers were asking follow-up questions on team climate when such information about team climate was volunteered. So, what if the interviewee answers a question by referring to team climate: would the interviewer ask follow-up questions to investigate this further? The results show that per interview, an average of four answers relate to team climate. Only 1 of those 4 answers, on average, was followed by a follow-up question on team climate, as demonstrated by Table 5.5. This means that on average, 3 out of 4 answers volunteering information about team climate per interview were not followed up by a question on team climate.

Table 5.5. Follow-up questions on team climate

When answer on team climate: follow-up question devoted to team climate?		
Average No answers on team climate	Average No answers on team climate – followed by a question on team climate	Average No answers on team climate – NOT followed by a question on team climate
4	1 (25%)	3 (75%)

2.4. Conclusions

Bank A is missing the team climate perspective in its own analysis of a misconduct case. Hardly any questions (2 out of 19 questions on average per interview) are asked on team climate aspects that might have facilitated the unethical behaviour shown in the misconduct case. On top of that, when an interviewee answers a question by spontaneously referring to team climate, hardly any follow-up questions on team climate are asked (1 out of 4 answers is followed-up on average per interview). This internal investigation suggests that team climate, harbouring social psychological root causes of unethical behaviour, is a *blind spot* for bank A.

Bank A's employees who were interviewed during this internal investigation, the interviewees, did not refer to team climate as much as expected when analysing the root causes of a misconduct case. Hardly any answers (4 out of 19 answers) referred to team climate aspects that might have facilitated the unethical behaviour shown in the misconduct case. Of a large majority of the interviews (23 out of 27 interviews) only up to 1/3rd of the interview was in any way related to team climate or any culture aspects that could have harboured root causes of the misconduct case that was investigated. The average proportion of words used during the interviews addressing 'team climate' root causes of misconduct is 17%.

The other 83% of words addressed other aspects related to the misconduct, such as fact checking and failures of procedures or support systems. The 17% share is likely to be an overestimation rather than an underestimation, due to the inclusion of whole paragraphs to avoid false negatives.

Finally, there is some evidence that this internal investigation is the best example that bank A could demonstrate to the supervisor. As requested by bank A's team that had executed the internal investigation, there was a telephone call with the department head of the internal investigation team who was keen to hear the supervisory appraisal of the quality of the investigation. Although his objective was to learn from the supervisory feedback, he also expressed his pride of this internal investigation stating that it was their best attempt to include team climate aspects into the investigation.