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

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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>

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Cover Page



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Date: 2018-03-29

A grayscale image of a petri dish containing several bacterial colonies of varying sizes and textures, including a large, dense, circular colony in the upper left and several smaller, more diffuse colonies scattered throughout the lower right.

Part II
Banking and supervisory practices

Chapter 6
**Study 2. Initial supervisory
requests: little effect**

Chapter 6

Study 2. Initial supervisory requests: little effect

1. Requesting behavioural data

Within the investment banking division of bank B, the financial supervision of behaviour and culture assessed a trading business that faced high integrity risk. High integrity risk refers to the heightened inherent risk of integrity conduct rules breaches by the business. This inherent risk can for instance be rooted in the fact that the business is closing large transactions with clients from corruption prone countries. The high integrity risk for the trading business in question, was identified by the financial supervisor as well as by bank B itself and drives up the misconduct risk, that is, the risk of one or more traders of those desks embarking on some form of unethical behaviour. The trading business was therefore selected by the financial supervisor for an expertise assessment of behaviour and culture.

At the start of this supervisory assessment, the supervisors asked bank B for behavioural data – as an indicator of team climate - of the trading teams with high misconduct risk. It was clarified to the bank that the behavioural data could be any form of records, statistics or numbers on conduct or (signs of) unethical behaviour that would allow the supervisor to form a first impression of the team climates within the trading business of focus through desk research.

1.1. Research question

The following research question is addressed in this way:

Research question

3. *To what extent are banks able to (re-)produce behavioural data, as an indicator of team climate of teams with high misconduct risk, when requested to do so by supervision?*

1.2. Approach

The supervisory request for behavioural data was made in a variety of forms, at different points in time, to different people within bank B. Despite of this variety the nature of the request was always the same: asking for any behavioural data at team level of the specific trading business. Behavioural data was defined to consist of any records, statistics or numbers on conduct or (signs of) unethical behaviour, such as breaches of limits, near misses or incidents. The results in the next paragraph show how promptly and to what extent bank B delivered the behavioural data as requested for by the financial supervisor.

1.3. Results

Table 6.1 lists six (repeated) supervisory requests over a period of eleven weeks. Three modes of requesting the data were used by the supervisor: written in an email (twice), verbally during a telephone call (once), and verbally during meetings (three times) – to four different individuals / functions within the bank. Despite of the repeated supervisory request of behavioural data, to a

variety of functions and in a variety of ways, the request remained unanswered by bank B. That is, bank B did not demonstrate the ability to reproduce statistics, records or numbers of behaviours or conduct at team level in a timeframe of 11 weeks.

Table 6.1. Six requests of behavioural data by the supervisor

	Form		Who		Time	
	Written or verbal	To whom	№ of weekdays since last requests	Week		
1	Written - email	Compliance officer, first point of contact for the assessment	-	1		
2	Verbal - call	Head of Compliance	3	2		
3	Verbal - meeting	Head of conduct team, responsible for conduct reviews	17	5		
4	Verbal - meeting	Audit / regulatory affairs	0 (same day)	5		
5	Written - email	Compliance officer, first point of contact for the assessment	1	5		
6	Verbal - meeting	Compliance officer, first point of contact for the assessment	29	11		

1.4. Conclusions

Bank B is unable to (re)produce data related to team climate - including records of breaches, near misses or incidents - of the teams within its high integrity risk trading business. Despite repeated requests by the supervisor, bank B showed to be unable to reproduce statistics or records on behaviour at these trading desks. They also did not specify what type of information they monitored for this purpose, even though they indicated that no incidents were reported. Behavioural data was broadly defined: bank B had the possibility to come up with any records, statistics or numbers on conduct or (signs of) unethical behaviour, such as breaches of limits, near misses or incidents. Despite the broad definition of data, and the acknowledged high integrity risk related to these specific trading desks, the request remained unanswered by the bank.

A second conclusion is that the supervisory request of behavioural data is ineffective. The request came from the financial supervisor, making it difficult and even against regulations for bank B to ignore. Furthermore, the supervisor uttered the requests to four different officers of different departments within the bank, in three different ways including verbally and in writing. This leaves no doubt that the request was received by bank B. And, the six requests were spread over a period of eleven weeks, giving bank B plenty of time to respond. Taken together, these observations make it reasonable to assume that requesting behavioural data of a bank as a financial supervisor will not result in further insight in team climates or the possible root causes of misconduct within these climates.

2. Requesting a root cause analysis

After assessing bank A's litigation report and its internal investigation of a misconduct case – as reported in Chapter 5 – supervisory experts of behaviour and culture requested of bank A to conduct a root cause analysis of its own misconduct cases. Bank A faced multiple misconduct cases, and would benefit from own insights regarding the root causes of these cases. Therefore the supervisor asked of bank A to conduct the root cause analysis itself. The objective of the root cause analysis, as discussed with the bank by the supervisor, was defined to analyse what root causes specifically in behaviour and culture are underlying the misconduct cases. The supervisor asked of bank A to conduct this root cause analysis, with a team climate perspective. To clarify what was meant by a team climate perspective, and to help and inspire bank A to analyse the root causes of its misconduct, financial supervision handed and explained to Bank A a description of the 'Corrupting barrels model'- as introduced in Chapter 3. Following this supervisory request, bank A conducted a root cause analysis on ten of its misconduct cases.

2.1. Research question

The following research question is answered in this paragraph:

Research question

4. *To what extent are banks able to conduct a root cause analysis of own misconduct cases with a team climate perspective, when requested to do so by supervision?*

2.2. Approach

To address the research question, the report of the root cause analysis on ten misconduct cases as conducted by bank A was analysed. To explore the misconduct reported, the number of observations and illustrative examples provided in the report were counted. Next, the culture patterns listed as root causes for the misconduct cases were analysed.

2.3. Results

Bank A starts off the root cause analysis report with the following two introductory statements:

- a. "Examples presented are the illustrations of sporadic individual failures but do not constitute the suggestion of systemic issues across the bank."
- b. "The behaviours displayed in presented examples are not accepted by the bank, and have resulted (where appropriate) in severe personal consequences for the individuals involved."

Statement a. clarifies that bank A regards the misconduct cases as individual misconduct incidents, that are not related to any organizational root causes. This legal disclaimer is aligned with the 'bad apple paradigm' that explains misconduct as unethical behaviour of single bad apples (the fraudulent traders), within a sound barrel (the organizational context). By opening the report with this disclaimer, Bank A shows to view the cases as individual incidents, and does not perceive or suspect patterns in the incidents or their root causes. Statement b. emphasizes that

bank A distances itself from the unethical behaviour displayed in the presented cases. It stresses that bank A has taken disciplinary measures regarding the individuals involved. This is aligned with the common response of the banking industry to misconduct that is, next to containment and strengthening control environments, focused on disciplinary measures and consequence management, instead of adopting a learning orientation (see Chapter 2).

The introductory statements are followed by a summary of 41 behavioural observations and 24 illustrative behavioural examples, summed up in Table 6.2, as detected by bank A in the (only) ten misconduct cases analysed. Thus, despite the in total 65 behavioural observations and examples observed in 10 cases, bank A claims that these are ‘sporadic individual failures’ and that these observations and examples do not suggest any ‘systemic issue across the bank’. The report does not show any true exploration of root causes related to culture or team climate.

Table 6.2. Culture patterns in 10 misconduct cases as defined by bank A

	Culture patterns in 10 misconduct cases as defined by bank A	Number of observations from misconduct cases provided	Number of illustrative examples provided
1	Lack of awareness / conflict of interest	7	3
2	Roles & responsibilities / lack of supervision	8	5
3	Lack of disclosure / transparency	7	3
4	Missing courage / mentality to challenge	5	2
5	Inappropriate communication	4	5
6	Inappropriate actions	7	3
7	Excuses	3	3
	Total	41	24

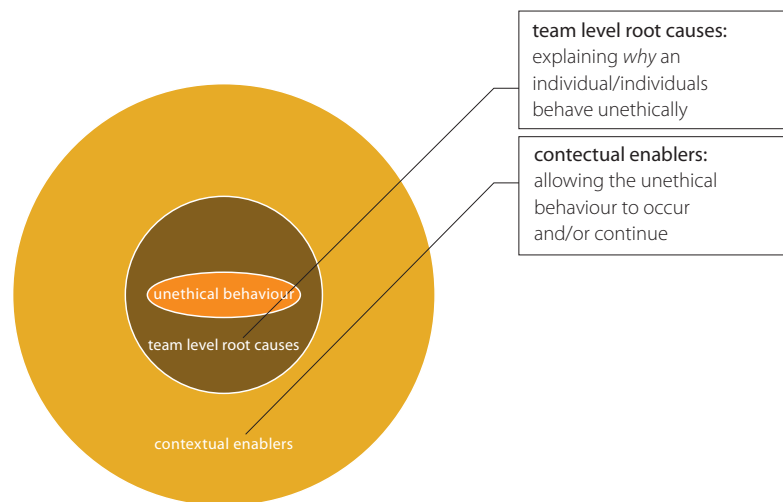
Table 6.2 also shows the seven ‘culture patterns’ identified in the report as root causes of the ten misconduct cases. I have related these culture patterns to the two levels of root causes in Figure 5.1 (repeated in Box 6). I categorized the culture patterns as provided by the report post-hoc: the report itself lacks an interpretation or further explanation of the seven culture patterns. The patterns are merely named and listed, not clarified. Therefore, my analysis and interpretation of the seven culture patterns is added in italics and between brackets, in the following paragraphs.

The first category of culture patterns describe the actual unethical behaviour displayed in the misconduct cases: inappropriate communications (pattern No 5: *inappropriate communication in chatrooms and through email, between employees and with third parties*) and inappropriate actions (pattern No 6: *inappropriate actions by employees, that breach conduct rules or regulations*). These two culture patterns (29% of all patterns) are not causing the misconduct, but merely describe the nature of the unethical behaviour that was demonstrated within the case. They are out of place in a list of root causes of misconduct. This category corresponds with the centre of the Figure displayed in Box 6: it details the unethical behaviour itself.

The second category of culture patterns is seeing to team level root causes of the misconduct cases. Two patterns out of seven (less than half, or 29% of all patterns) fall in to this category: lack of awareness / conflict of interest (pattern No 1: *low awareness on risk or rules around conflicts of interest*), and excuses (pattern No 7: *excuses: justifications of unethical practices*). These patterns indicate team climates that contributed to what caused the individuals involved to behave unethically. The patterns suggest team climates facilitating misconduct. This category of root causes corresponds with the inner ring or middle level of the Figure displayed in Box 6, and represent actual root causes of unethical behaviour at team level.

Finally, the third category contains three patterns out of seven (almost half, 43% of all patterns), identifying contextual enablers of the unethical behaviour: roles & responsibilities / lack of supervision (pattern No 2: *lack of oversight, possibly allowing the misconduct to occur*), missing courage / mentality to challenge (pattern No 4: *absence of challenge or voice behaviour, possibly allowing the misconduct to continue*) and lack of disclosure / transparency (pattern No 3: *absence of disclosure or speaking up, possibly allowing the misconduct to occur or continue*). These patterns refer to conditions or circumstances that contributed to the opportunity to behave unethically, and/or that allowed the unethical behaviour to continue. This category of root causes corresponds with the outer ring of the Figure displayed in Box 6: contextual enablers of unethical behaviour.

Box 6. Figure 5.1 repeated: Two levels of root causes of misconduct



2.4. Conclusions

Bank A has conducted a root cause analysis of its misconduct cases, as an answer to an explicit supervisory request to consider team climate. Requiring this root cause analysis as a financial supervisor is insufficiently effective: less than half of the root causes considered actually address team climate (49%). The other half of the root causes considered by the bank's analysis, refer to organizational conditions allowing misconduct to occur ('contextual enablers', 29%) or further detail the actual misconduct itself ('unethical behaviour', 29%). Thus, the root causes analysis conducted by bank A provided the bank little insight in or deepened understanding of the way team climate facilitated unethical behaviours, needed to prevent future misconduct.

The conclusion that bank A has difficulty conducting a root cause analysis that addresses team climate, is based on three results. First, bank A upholds the 'bad apple perspective' by stating upfront in two legal disclaimers that there are no systemic issues, and that the cases are due to sporadic individual failures. This 'bad apple perspective' is incongruent with the large number of observations and illustrative examples listed in the report, and with the actual objective of conducting a root cause analysis from a team climate perspective. Stating that there are no systemic issues ahead of time, makes a root cause analysis on possible contextual and culture factors very difficult. Second, the seven culture patterns as identified by bank A lack a clarification or explicit interpretation. The patterns are named and listed, but not defined, explained or further analysed. Third, in my interpretation of these patterns, the identified root causes appear to be a mix of descriptions of actual unethical behaviours (i.e. inappropriate communications in chatrooms), organizational conditions that permit misconduct (i.e. lack of oversight), and potential root causes related to team climate (i.e. low risk awareness). This mix, and inconsistency in the patterns identified by the report as root causes, indicate little understanding by bank A of how team climate can facilitate misconduct.