



← 22-51  
**WALL ST**

# **Managing Banks with Divergent Cultures**

**Alan D. Morrison, Saïd Business School, University of Oxford**

**CFS FIRM-Conference on Non-Financial Risk**

**Goethe University, 12 March 2020**

O tempora,  
o mores!

Wells Fargo

+ Add to myFT

# Wells Fargo to pay \$575m more over sales practices

Settlement with 50 US states is latest over fake accounts and mis-selling scandals

Robert Armstrong in New York DECEMBER 28 2018

Banking is not what it used to be

Partnerships have been replaced by joint stock firms

Client relationships have weakened

Cultures have changed

Cultural failure increasingly an apparently serious source of risk

**Royal Bank  
of Scotland**

## RBS facing £400m bill to compensate small business customers

Bank apologises for poor treatment during financial crisis and will automatically refund fees

**Jill Treanor**

Tue 8 Nov 2016  
17.53 GMT





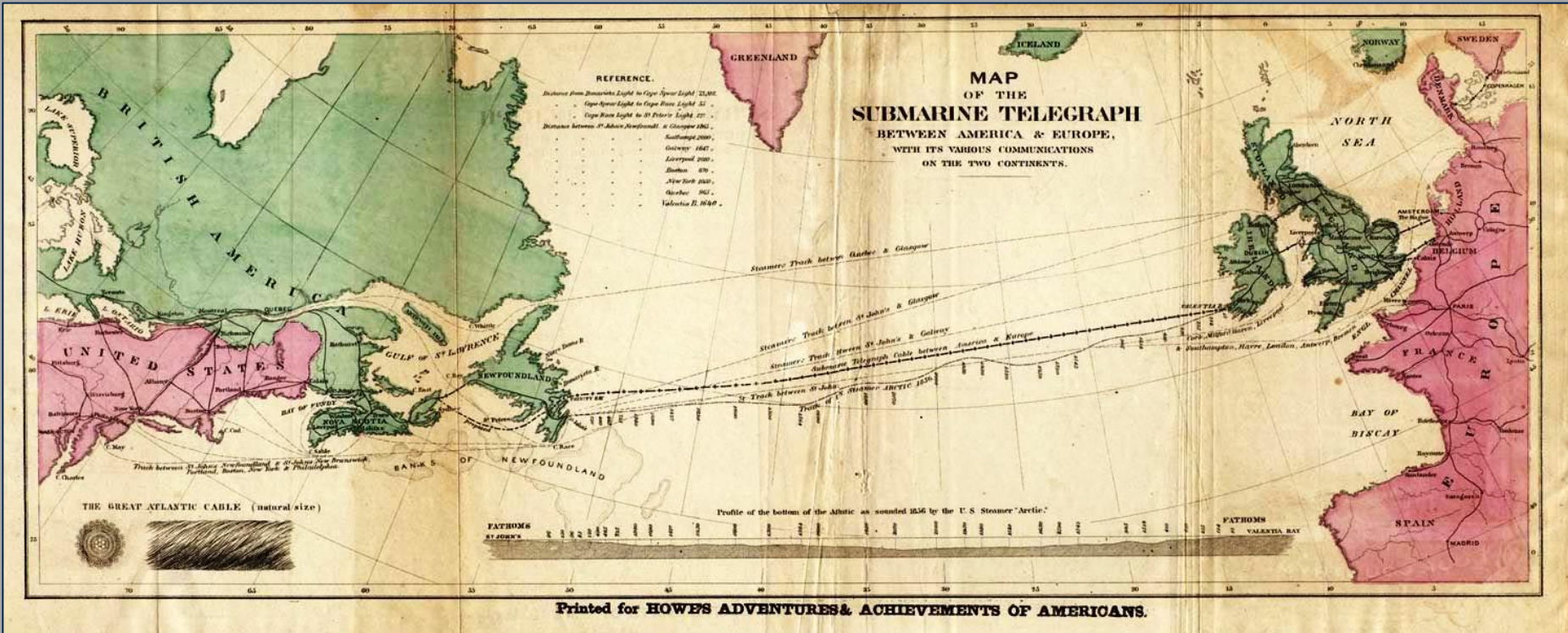
Investment banking grew out of Atlantic commodity trading

Weak commercial law, unpredictable courts, poor communications

Early players included Rothschilds (18th C, linen traders), Barings (1763, commodity traders), Brown Brothers (1790s, linen), Peabody (1814, dry goods)







Mid-19<sup>th</sup> Century advances in commercial and contract law

1866: Trans Atlantic cable

Brown, Barings, and JP Morgan withdrew from commodities trading in the 1870s and 1880s

# Assemble SAGS

1. Our clients' interests always come first
2. Our assets are our people, our capital, and reputation. If any of these is ever damaged the last is the most difficult to restore

(First and second of Whitehead's fourteen business principles)

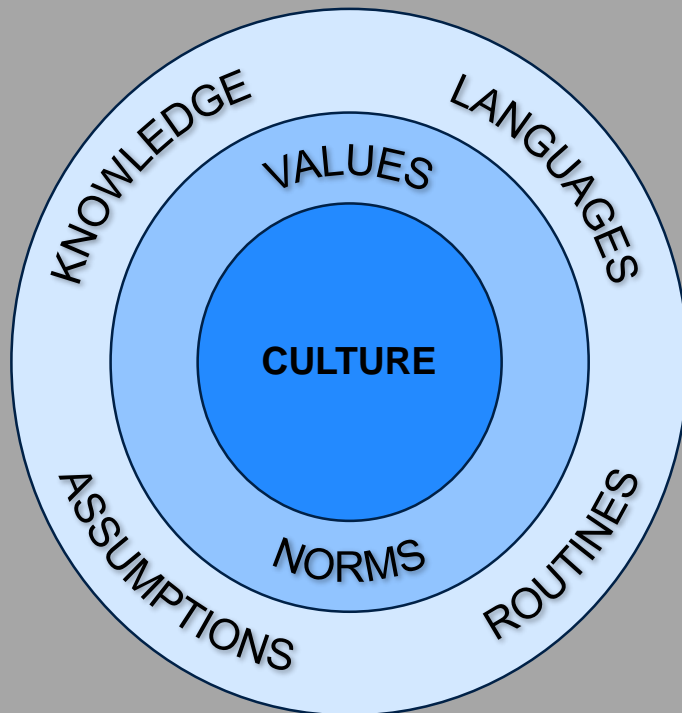
# Cultural foundations

Bower (1966): “The way we do things around here”

Kreps (1990): A common understanding of how to act when contract impossible

Cremer (1993); Lazear (1999): Shared understandings that facilitates communication

Schein (2004): Culture is manifested in organizational artifacts: the location of the water cooler, who smokes together, who goes to a wine bar, what sort of language is deemed appropriate, ...



Culture is a shared set of behaviours and beliefs, evolved to address common problems (Patterson 2014)

It is usually tacit and frequently unexamined

When we lack a deep understanding of our environment, it is natural to follow culturally assigned roles

Moral education is closely linked to the acquisition of culture

## Implications

Culture arises for a given network of employees

Network reflects physical and work interaction

There are multiple networks/cultures in banks

Networks may extend across banks

Culture is difficult for outsiders to understand

Shared understandings and language

These phenomena may lock out regulators and even senior management

Big banks have multiple cultures

That fact is a consequence of the technological context

Understanding cultural types is important for risk managers

In a market system based on trust, reputation has a significant economic value. I am therefore distressed at how far we have let concerns for reputation slip in recent years. (Alan Greenspan, 2 Oct 2018)



[Combining traditional banking functions with] a system of highly rewarded - very highly rewarded - impersonal trading *dismissive of client relationships* presents *cultural conflicts* that are hard - I think really impossible - to successfully reconcile within a single institution. (Paul Volcker, 23 Sep 2012)

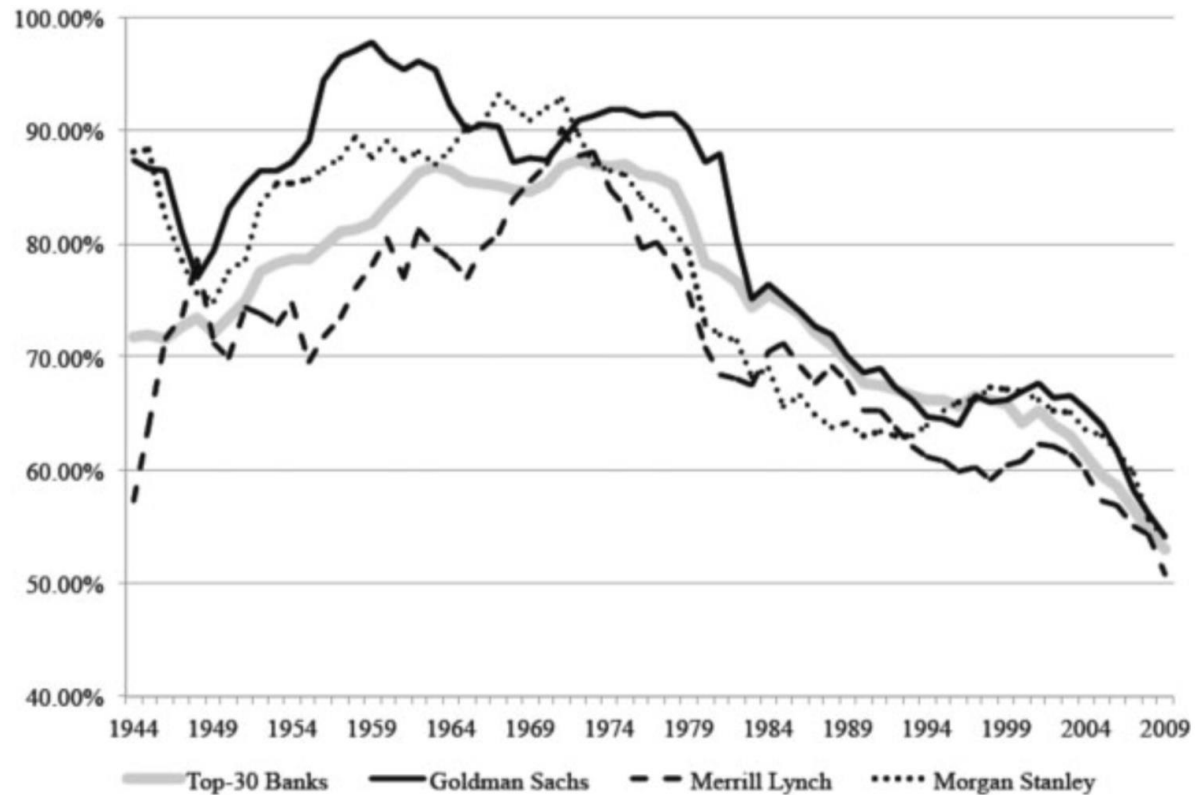
There is evidence of deep-seated *cultural and ethical failures* at many large financial institutions. Whether this is due to *size and complexity*, bad incentives or some other issues is difficult to judge... (William Dudley, 7 Nov 2013)





**Table 3. Exclusivity data for major banks from 1933 to 1969**

<b>Banks</b>	<b>Clients</b>	<b>Exclusive Relationship (%)</b>	<b>% of Client's Deals Managed</b>
Morgan Stanley & Co.	182	60.99	69.34
First Boston Corp.	355	45.63	42.60
Kuhn, Loeb & Co.	160	56.88	62.44
Lehman Bros.	340	57.65	46.35
Halsey, Stuart & Co.	212	16.04	24.68
Dillon, Read & Co.	132	68.94	58.41
Blyth & Co.	315	59.37	42.62
Goldman, Sachs & Co.	305	67.54	63.43
White, Weld & Co.	269	60.97	39.74
Kidder, Peabody	417	67.63	39.35
Smith, Barney & Co.	162	55.56	42.11
Salomon Bros.	132	27.27	18.88
Eastman Dillon, Union Securities & Co.	237	64.14	41.93
Merrill Lynch	186	51.08	30.67
Harriman Ripley & Co.	83	38.55	25.34



**Figure 1**  
**Bank-firm relationship exclusivity**

The figure reports an annual measure of a bank's average relationship strength among firms for which the bank managed at least one deal during the preceding 10 years. Relationship strength is the bank's share of proceeds raised by a firm during the 10-year rolling window. The average relationship strength among the top-30 banks is calculated using the average relationship strength for each of the 30 banks in the issuer's choice set for a given year used in the econometric analysis.

Morrison, Schenone, Thegeya, Wilhelm (2018)

$$c = S_0 N(d_1) - K e^{-rT} N(d_2)$$

$$p = K e^{-rT} N(-d_2) - S_0 N(-d_1)$$

$$\text{where } d_1 = \frac{\ln(S_0 / K) + (r + \sigma^2 / 2)T}{\sigma \sqrt{T}}$$

$$d_2 = \frac{\ln(S_0 / K) + (r - \sigma^2 / 2)T}{\sigma \sqrt{T}} = d_1 - \sigma \sqrt{T}$$

Financial engineering

#### CROSS-BORDER SWAPS REPRESENTATION LETTER

ISDA

Safe,  
Efficient  
Markets



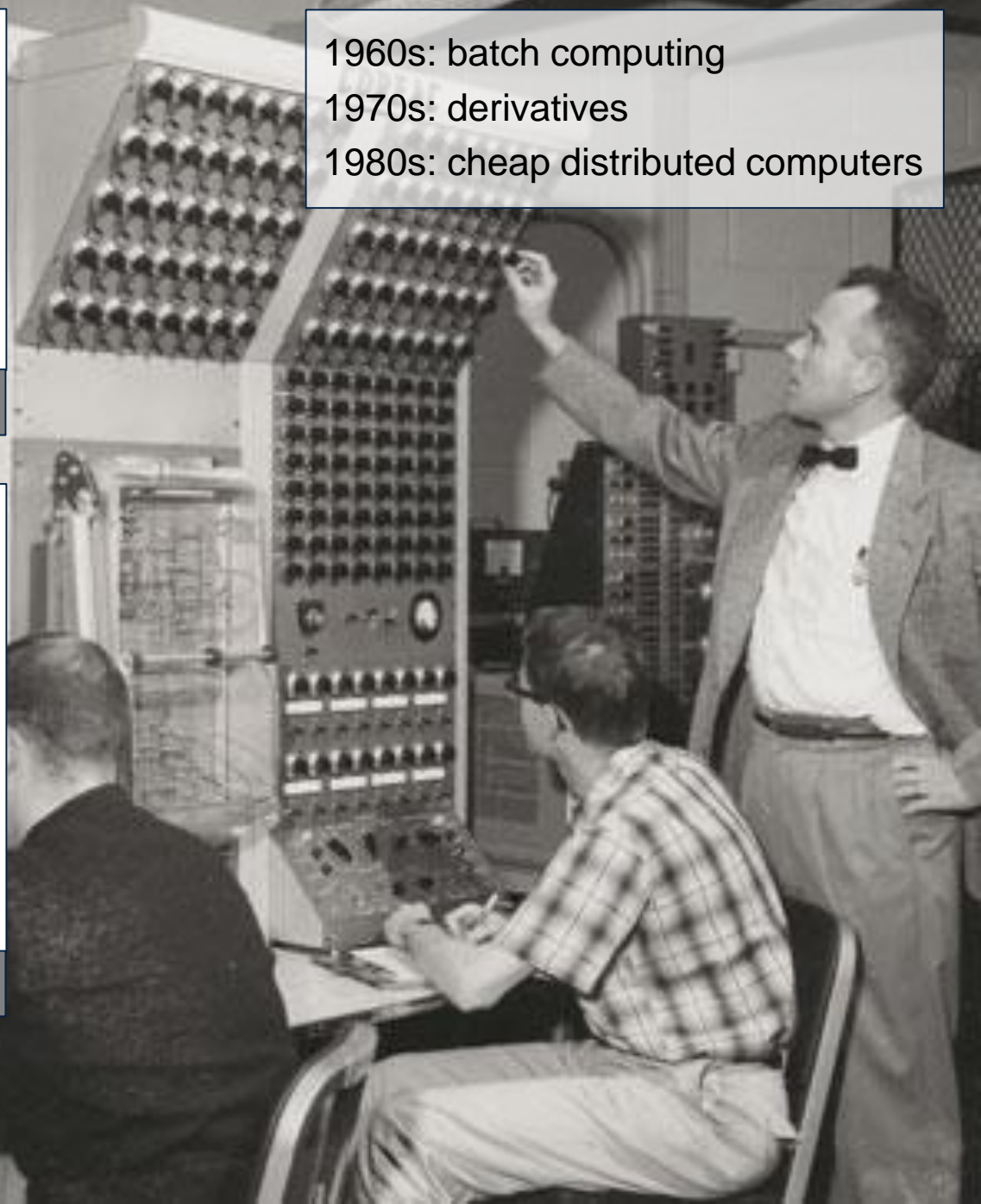
We hereby represent to you as of each time we enter into a Swap Transaction with you that, unless we have notified you to the contrary in a timely manner in writing prior to entering into such Swap Transaction, **our obligations to you in connection with the relevant Swap are not, supported by any Guarantee (of which we are aware)** other than any Guarantee provided by a person who we reasonably believe does not fall within any of the U.S. Person Categories and who we believe in good faith would not otherwise be deemed a "U.S. person" under the Interpretive Guidance.

Legal innovation

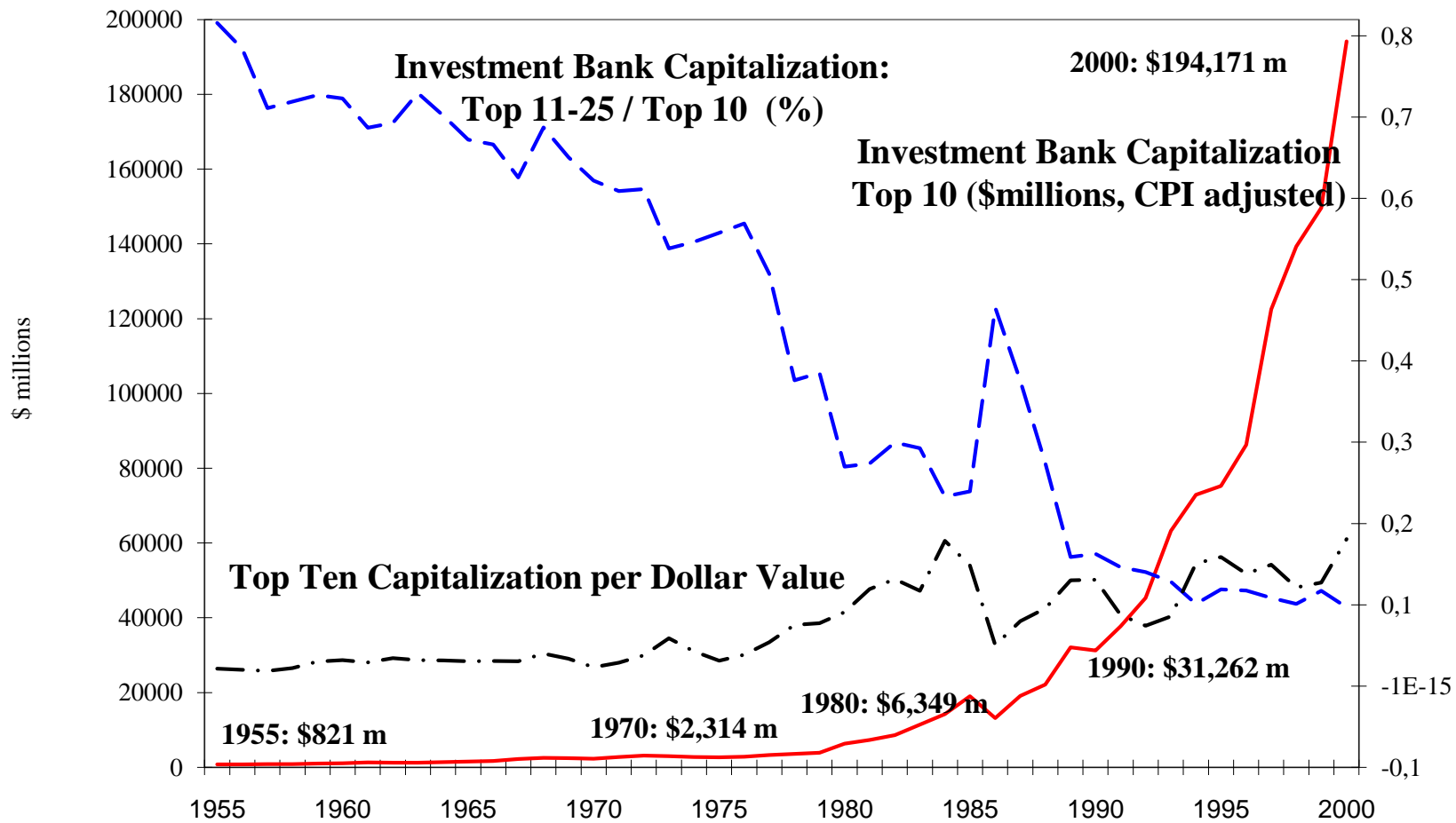
1960s: batch computing

1970s: derivatives

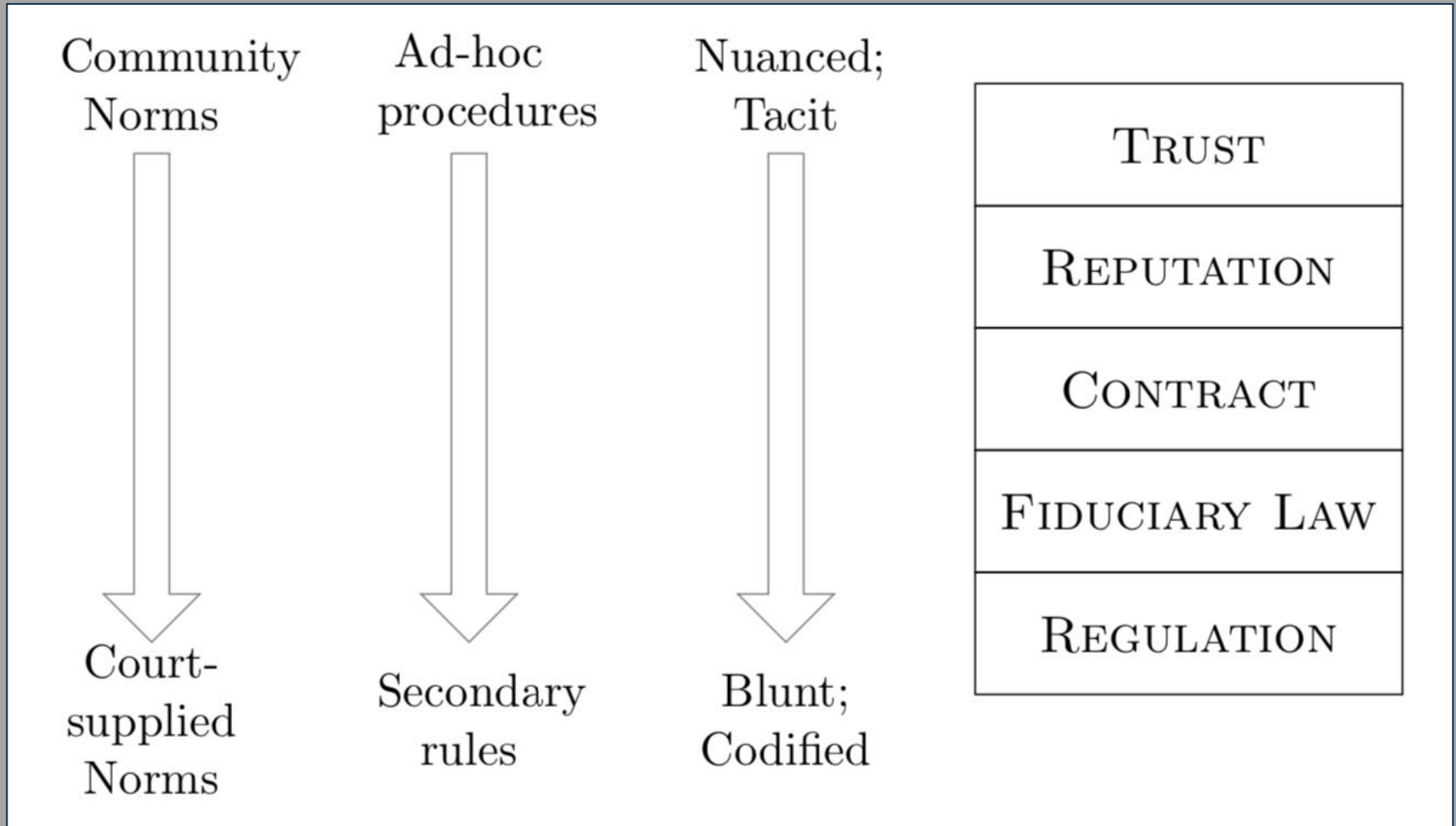
1980s: cheap distributed computers





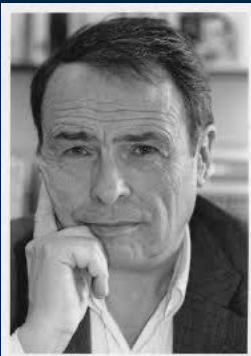


Morrison and Wilhelm (2008)



Morrison and Wilhelm (2015, Fig. 1)

## Culture is stickier than context

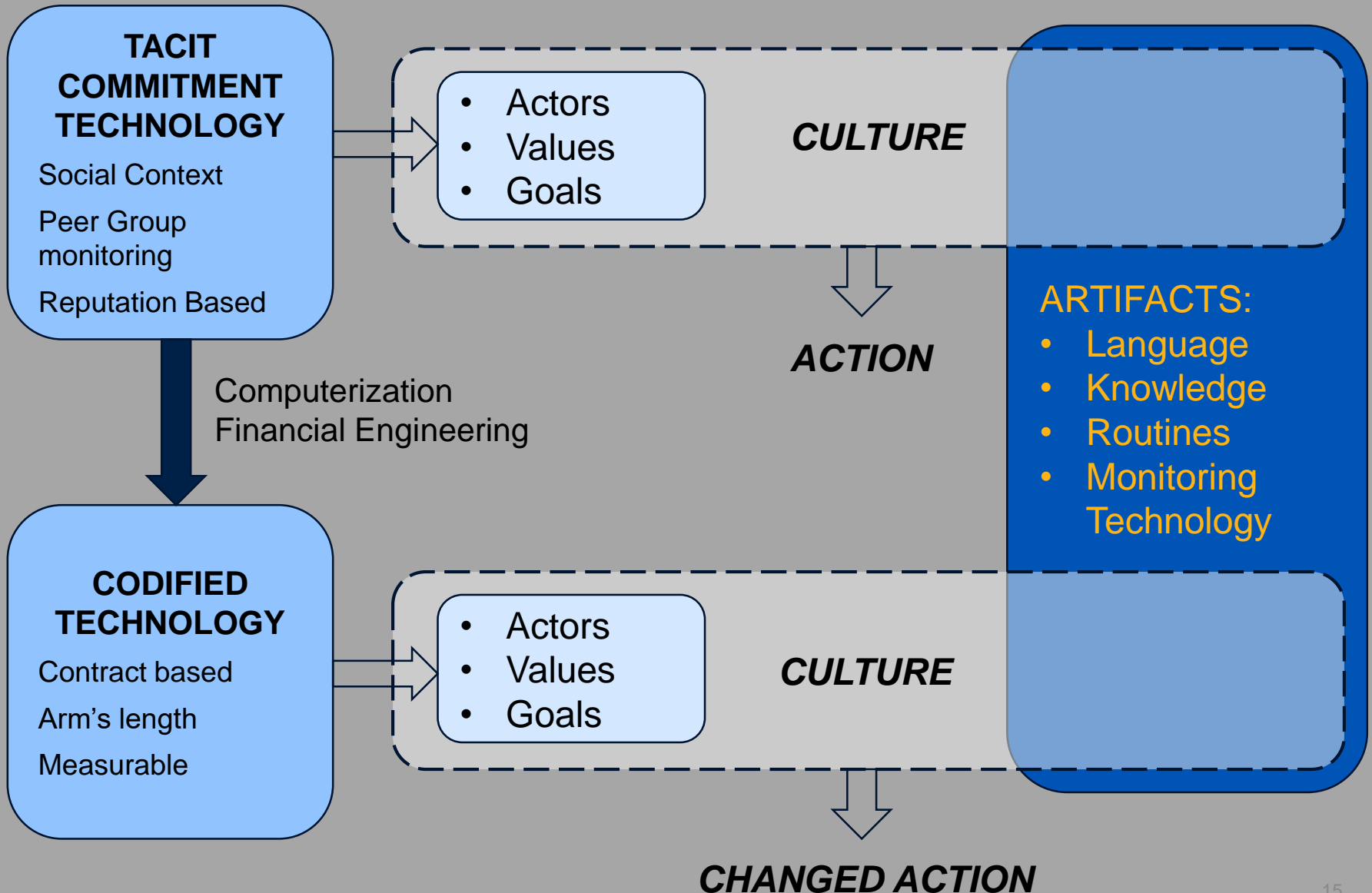


Morrison and Wilhelm (2015): investment banks formed as partnerships to tie members to the firm's reputation, allowing them to ask in clients' best interest in non-contractible situations

Morrison and Wilhelm (2007, 2008): computerization and financial engineering moved reputation-based relationships to arms length/ contractual transactions

Almost all financial activities have become more codified and arm's length. But the networks and cultures remain (c.f. remarks in the previous session about the failure of culture to keep pace with technological change)





# Forex Trading



## WM/Reuters 4pm fix

- Created by Edinburgh actuaries for pension valuation
- Widely used to settle trades and for index trading
- Performed Thomson Reuters Matching and EBS platforms
- Sixty one snapshots 30 before to 30 seconds after 4pm
- Last trade in each window identified as buy or sell, and mid price imputed
- Average mid is the fix

- Traders organized themselves into groups: “the players,” “the three musketeers,” “the mafia”, “the A-team”
- Chatroom communication designed to influence the fix

“Loved that mate... worked lovely... pity we couldn’t get it below the 00”

“There you go...go early, move it, hold it, push it”

“nice work gents I don my hat””

“hooray nice teamwork””

““Will he tell rest of desk stuff...or god forbid his nyk [New York office],’ one trader asks. ‘That’s really imp[ortant] q[uestion],’ another trader responds, adding: ‘don’t want other numpty’s in mkt to know [sic]... is he gonna protect us like we protect each other against our own branches?’” (Citi, JP Morgan, UBS traders)

**Private languages**

**Closed networks**

**Established for a pre-electronic market**



# Understanding FOREX culture from the outside

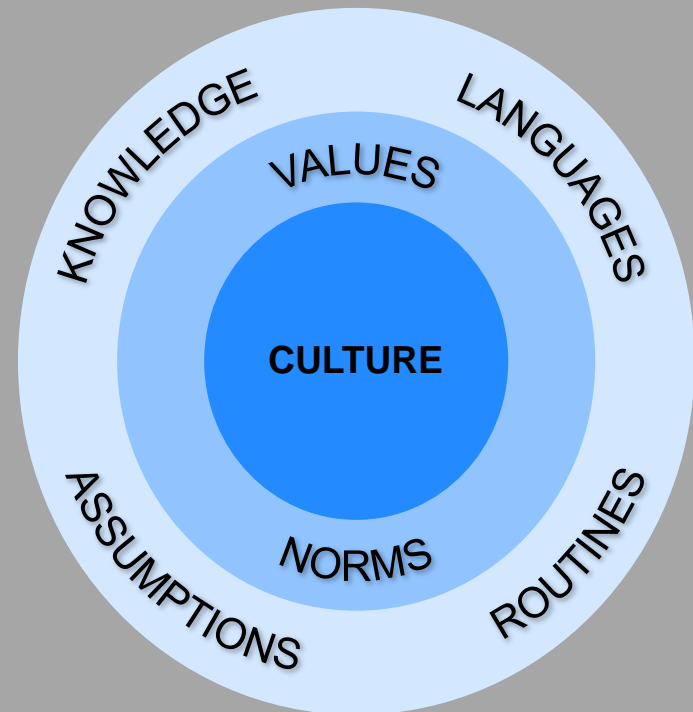
CFTC: "Certain chat room participants used code words to evade detection by their banks' compliance monitoring systems"

Investigators are hampered by limited understanding of the unusual 'dialect' used by forex traders (FT.com)

"crushingly boring...pure garbage...difficult to decipher" (investigator)

Of course, some regulators faced cultural conflicts of their own

Short-term systemic stability concerns may undermine their incentives to intervene

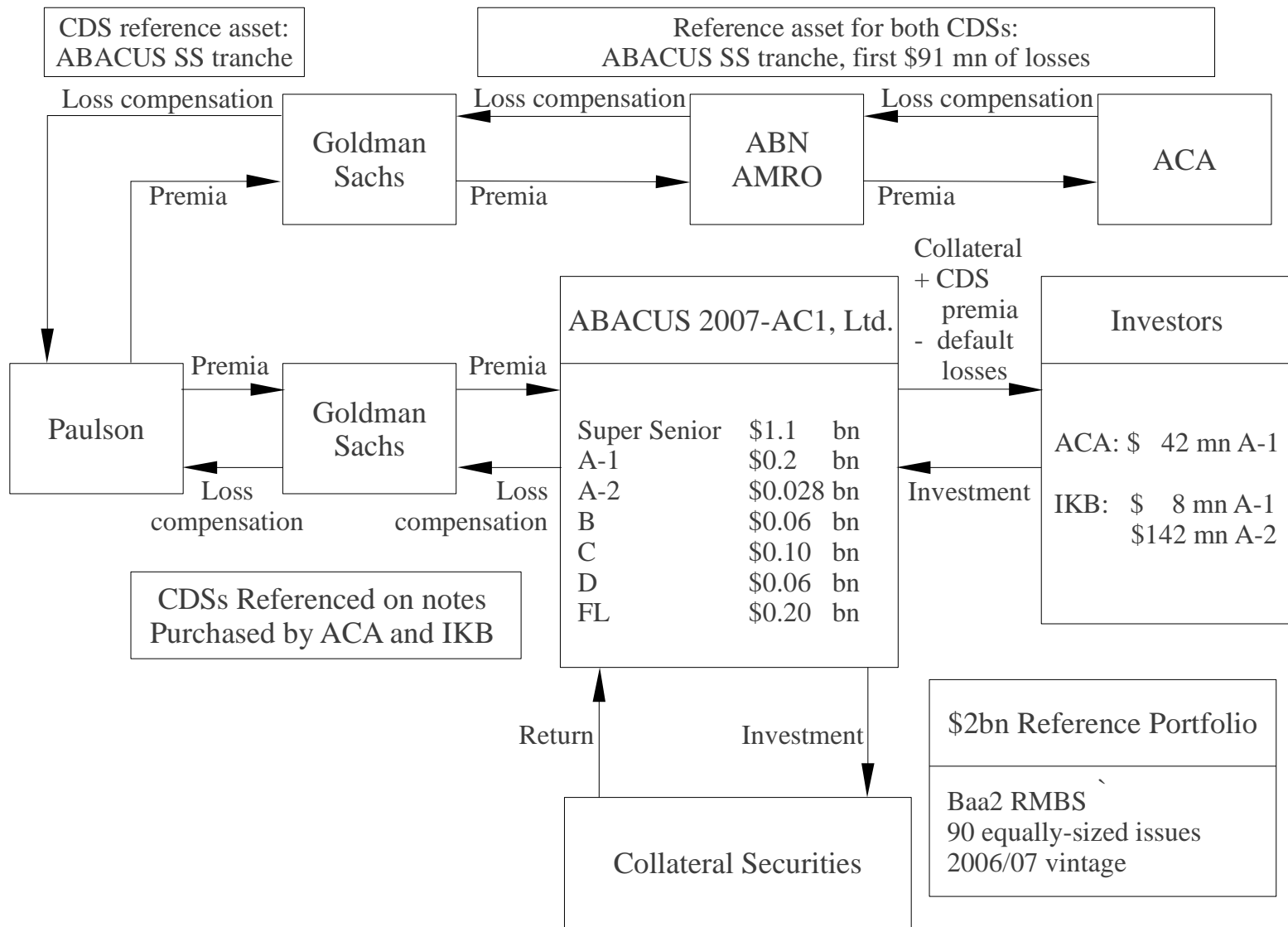




16 April 2010: SEC files a civil complaint against Goldman Sachs alleging that Goldman engaged in fraud in connection with a 2007 synthetic collateralized debt obligation, ABACUS 2007-AC1 SPV

Goldman's market value drops about \$10bn on announcement

15 July 2010: Goldman settles the case for \$550 mn



Davidoff, Morrison, Wilhelm (2012: Fig 1)



# Senate Homeland Security and Governmental Affairs Subcommittee on Permanent Investigations Hearing on Wall Street and the Financial Crisis





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**From:** Tourre, Fabrice  
**Sent:** Tuesday, January 23, 2007 11:34 PM  
**To:** Serres, Marine  
**Subject:** Fw: ft--friday

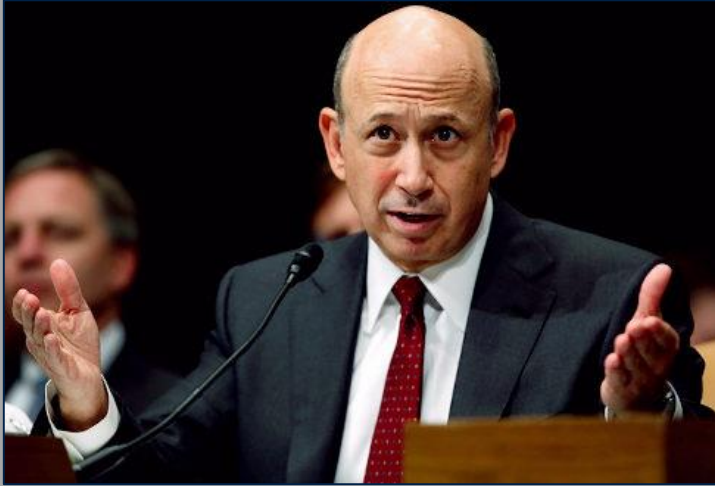
[Redacted] = Redacted by the Permanent  
Subcommittee on Investigations

[Redacted] you should take a look at this article... Very insightful... More and more leverage in the system, l'edifice entier risque de s'effondrer a tout moment... Seul survivant potentiel, the fabulous Fab (as Mitch would kindly call me, even though there is nothing fabulous abt me, just kindness, altruism and [Redacted]), standing in the middle of all these complex, highly levered, exotic trades he created without necessarily understanding all the implications of those monstrosities !!! Anyway, not feeling too guilty about this, the real purpose of my job is to make capital markets more efficient and ultimately provide the US consumer with more efficient ways to leverage and finance himself, so there is a humble, noble and ethical reason for my job ;) amazing how good I am in convincing myself !!!

-----Original Message-----

**From:** Tourre, Fabrice  
**Sent:** Wednesday, June 13, 2007 4:04 PM  
**To:** Serres, Marine  
**Subject:** Re: Good morning sunshine

Just made it au pays de tes clients preferres !!! Je viens d'ailleurs de vendre qqes bonds abacus a des veuves et orphelins que j'ai croises dans l'aeroport, decidement ces belges adorent les synthetic abs cdo^2 !!!



What the clients are buying [...] is [...] an exposure. [...] They are not coming to us to represent what our views are [...] They shouldn't care. [...] Just think of buying [...] on a stock exchange or futures market. [...] You're not even supposed to know who's on the other side.

*(Lloyd Blankfein, CEO Goldman)*



[...] let me just explain in very simple terms what synthetic CDOs are. [...] They are instruments that are created so that people can bet on them. It's the la la land of ledger entries. [...] You are the bookie, you are the house. You have less oversight and less regulation as you all began this wild, wild west of tranches, waterfalls, equity tranches, residual ware- housing. As you began all that, you had less oversight than a pit boss in Las Vegas.

*(Senator Claire McCaskill (Missouri))*

I think most people in Las Vegas would take offense at having Wall Street compared to Las Vegas

*(Senator John Ensign (Nevada))*

# Two modes of investment banking

**RELATIONAL**  
Using relationships  
where law does not run

**Pujo Committee, 1912**



Morgan: The first thing is character, before money or anything else. Money cannot buy it. A man I do not trust could not get money from me on all the bonds in Christendom. I think that is the fundamental basis of business.

Untermeyer: Is not commercial credit based primarily upon money or property?

Morgan: No, sir; the first thing is character

**TECHNOCRATIC**  
Finding legal and



**Qualification/Education Essential:** An academic degree (MSc or PhD) in a quantitative field, preferably (financial) mathematics, econometrics or physics.

**Experience/Knowledge Essential:** Years of quant experience, with familiarity with stochastic calculus, financial markets and the most important developments (for e.g. FRTB); Strong knowledge and experience with programming languages, especially C++ and Python.



# Braided investment banks



Relational and technocratic modes of business are *braided* in the modern investment bank

The cultural norms in each business are different

Relational: Trust, character, relationship, advise, predictability

Technocratic: Cleverness, structuring, innovating

Marrying the two cultures is a serious challenge

# Governing the braided bank

## Global M&A Boutique Revenue Ranking

Rank	Bank	Revenue \$m	% Share
1	Evercore Partners	144.2	2.9
2	Centerview Partners	123.0	2.5
3	Moelis & Co	94.6	1.9
4	Perella Weinberg Partners	57.9	1.2
5	Houlihan Lokey	52.5	1.1
6	Qatalyst Partners	34.2	0.7
7	Zaoui & Co	22.9	0.5
8	PJT Partners	18.2	0.4
9	Greenhill & Co	17.0	0.3
10	Lincoln International	11.3	0.2

Boutique banks

Report of the  
Business Standards Committee

Codified culture

ISDA<sup>®</sup> | Safe,  
Efficient  
Markets

Private law



Chancellor Strine, Delaware Court of Chancery

The courts

# Cultural risk management

There can be many cultures within a firm, and cultures may span firms.

Cultures form to solve economic problems, but may turn bad when new problems and new values encounter the artifacts of previous culture

Culture is hard for senior management and regulators to understand; senior management may not have the incentives to solve a cultural failure anyway.

Mapping networks and embedding senior management, increasing monitoring incentives, and promoting licensing bodies may help

# Conclusion

In banking, the technocrats and the relational bankers have different skills and different cultural understandings

Computerisation and legal innovation will only worsen the situation

Banks are innovating with organizational structure, legal mechanisms, and cultural management

But, if the cultural conflict impairs the professional judgment of bankers, there is a role for the judgment of courts

Understanding how this can best be exercised is not yet understood

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