

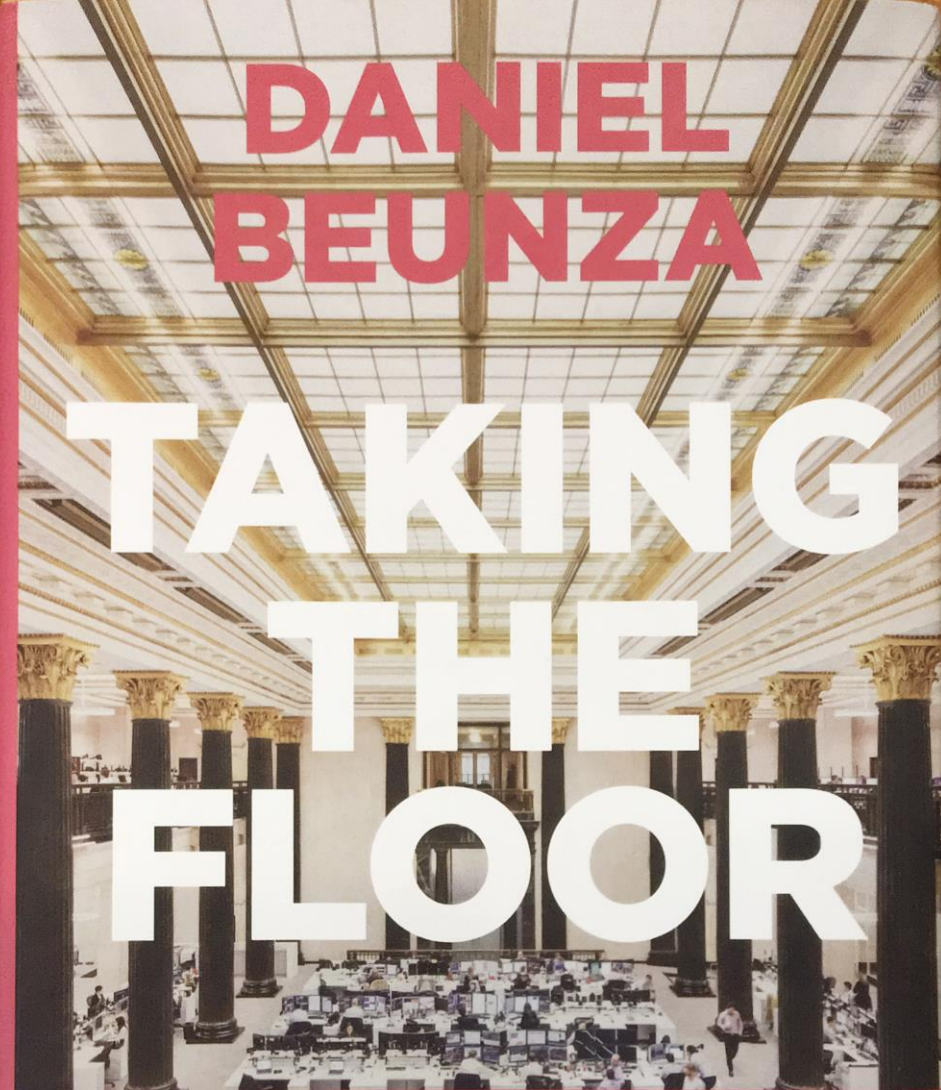
# Taking the Floor

**Daniel Beunza**

Cass Business School,  
SRC/ LSE

Presentation at the  
Systemic Risk Centre/  
LSE

October 11, 2019



**MODELS, MORALS, AND  
MANAGEMENT IN A WALL  
STREET TRADING ROOM**



**LIVE**  
12:39 pm ET

**FINANCIAL REGULATIONS**

**WILLIAM DUDLEY**  
Federal Reserve Bank of New York  
President & CEO

**C-SPAN**  
c-span.org  
@cspan

# Bank culture

- William Dudley, NY Fed, 2014:
  - “Culture is what people do when no one’s looking.”
- UK Salz Review:
  - “Bankers were engulfed in a culture of ‘edginess’ and a ‘winning at all costs’ attitude.”
- UK Banking Standards Board:
  - “To promote high standards of behaviour and competence.”











“Wall Street banks are badly managed. Too large, too complex.”

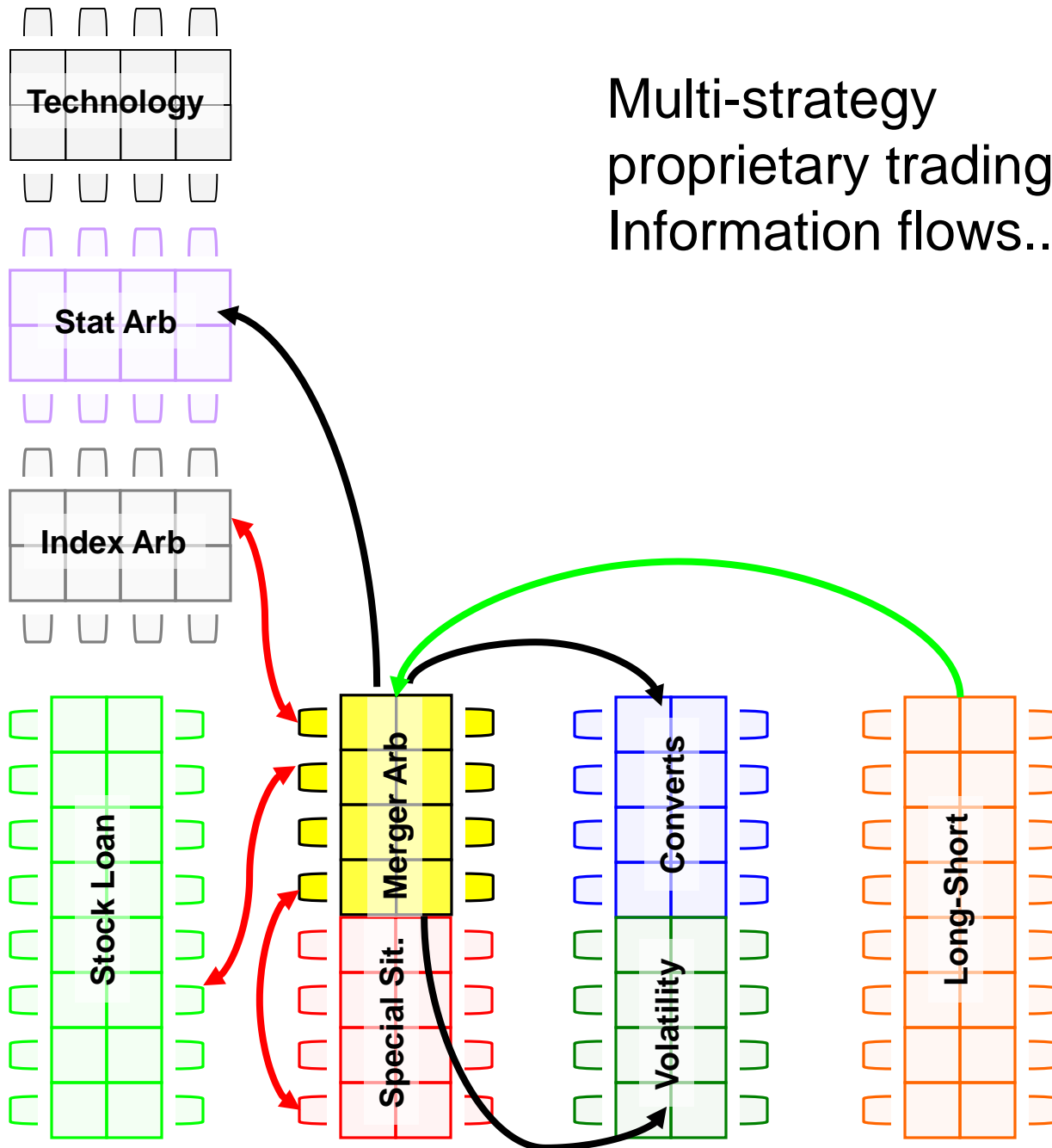
“Mark my words: when the next crisis comes, not one but two of the large banks will disappear”

Bob's trading room was not representative, but illustrative









Multi-strategy  
proprietary trading  
Information flows...

“If the boss does not give the trader the same bonus as others, the trader will go, ‘I heard Joe at a party, he got five hundred thousand. What, don’t you like me?’”

“Say someone lost money and is due no bonus, but you give them forty thousand. What happens? He’s insulted. He quits.”

### **Organizational justice**

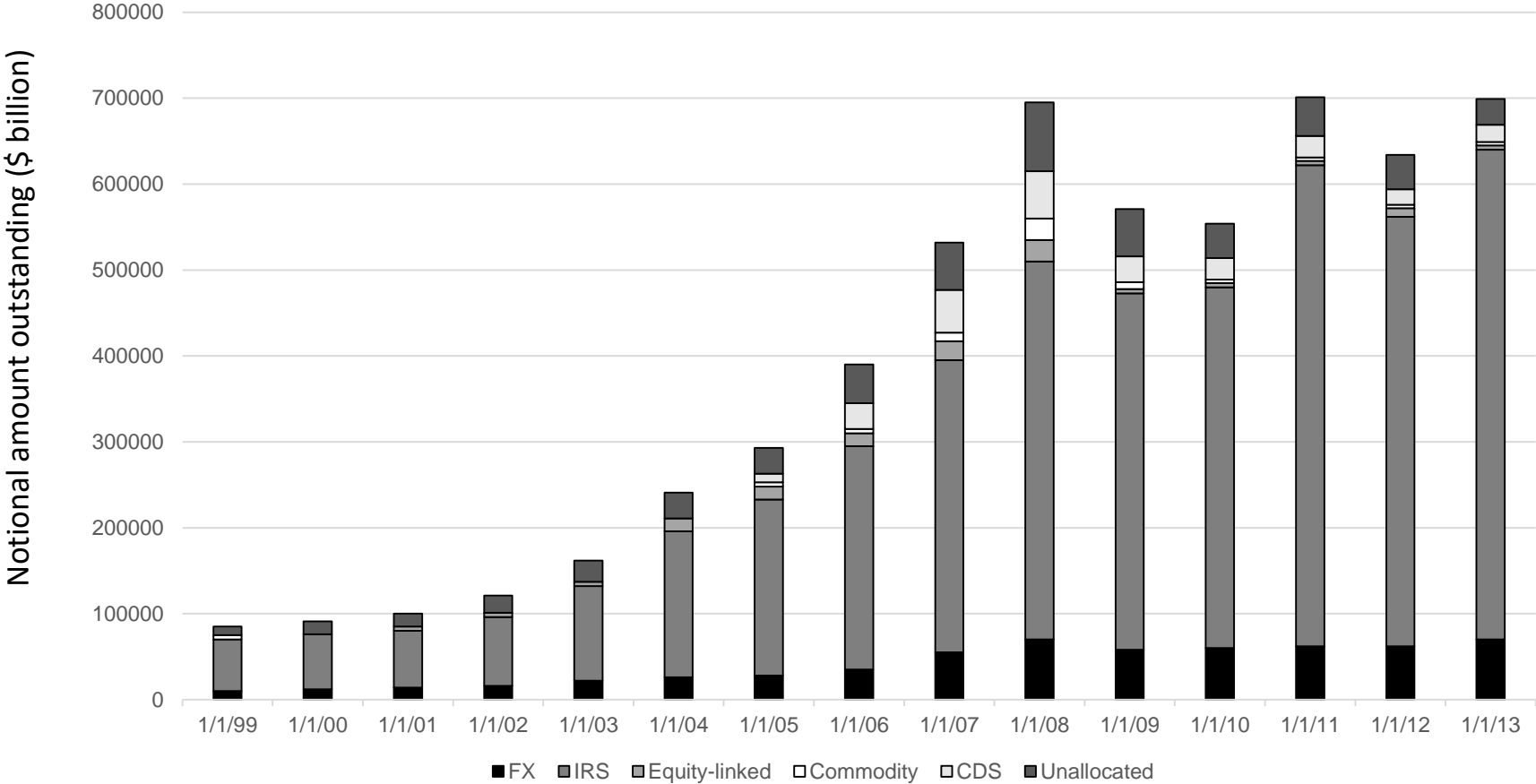
Perceptions of injustice impact job attitudes and behaviors at work (Greenberg, 1987)



- Co-head and a few others were late. “I had everyone come in the room, and then I locked the door.
  - “Bob, can we come in?”
  - “No, none of you can come in. You’ll have to spend time with me alone. That’s your punishment.”
- “The reputation that I developed, which I allowed to persist, was that I would burn down my own house before I would compromise with my principles or my rules”

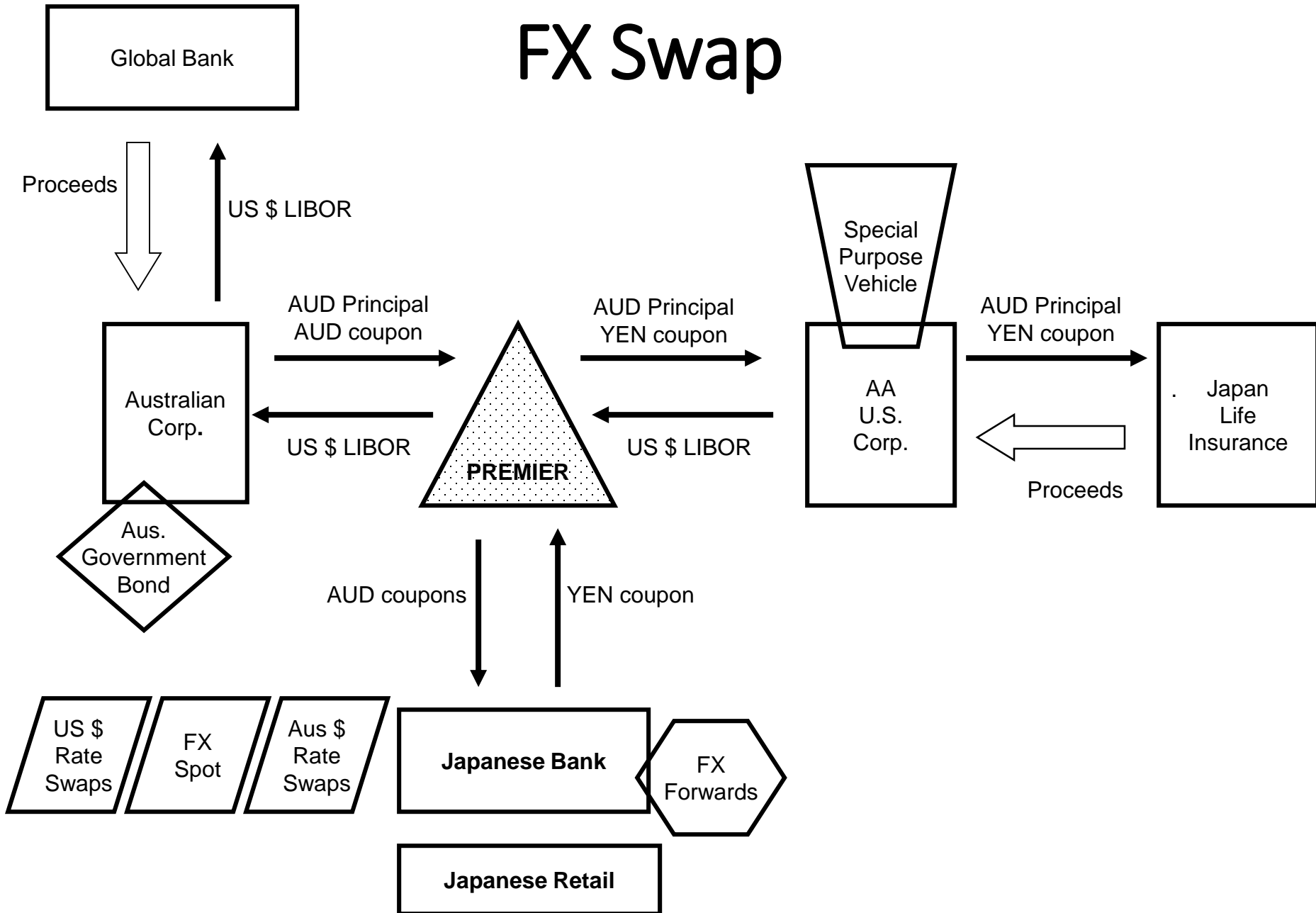
From market incentives to organizational norms

# Over the counter derivatives market





# FX Swap



# 1987-1995 Premier Financial

- “Equity derivatives, commodity derivatives, credit derivatives ... the absolute globalization of the business.”
- Premier “was the innovation firm. They were in the vanguard of the derivatives revolution, thinking of organizing around rational, mechanistic structures, and imagining how well ordered it would be.”

A discourse of rationality and disruption



# Scandal

- Bob: “I resolved every dispute and all the customers were satisfied in the end.”
- But was criticized by top management
  - “They [top managers] felt that the customers had signed the contracts, so the customers should pay.”

Transforming customers into counterparties

# Introduction of models

- Premier quantified the cost of risk
- Bank introduced Value at Risk to help Bob manage risks in the derivatives book
  - “So, you may think you're taking too much interest rate risk but maybe proprietary trading has the opposite [view]. ‘So, Bob, what's your problem? Step on the gas.’”

## **Economization (Caliskan and Callon 2008)**

The assembly and qualification of actions, devices and analytical/ practical descriptions as ‘economic’ by social scientists and market actors

- But... the model was imperfect
  - “Traders absolutely hated it. They spent all day examining the risk management system, finding its intellectual deficiencies to humiliate them and to drive around the barrier.”

### **Moral disengagement (Bandura 1996)**

A perception of unfairness can lead to the detachment of immoral behaviors from self-condemnation or other negative emotions

# Model-based moral disengagement

- **A discursive-material mechanism**
  - The weakening of self-condemnation caused by perceptions of injustice associated with the use of imperfect models to manage the organization

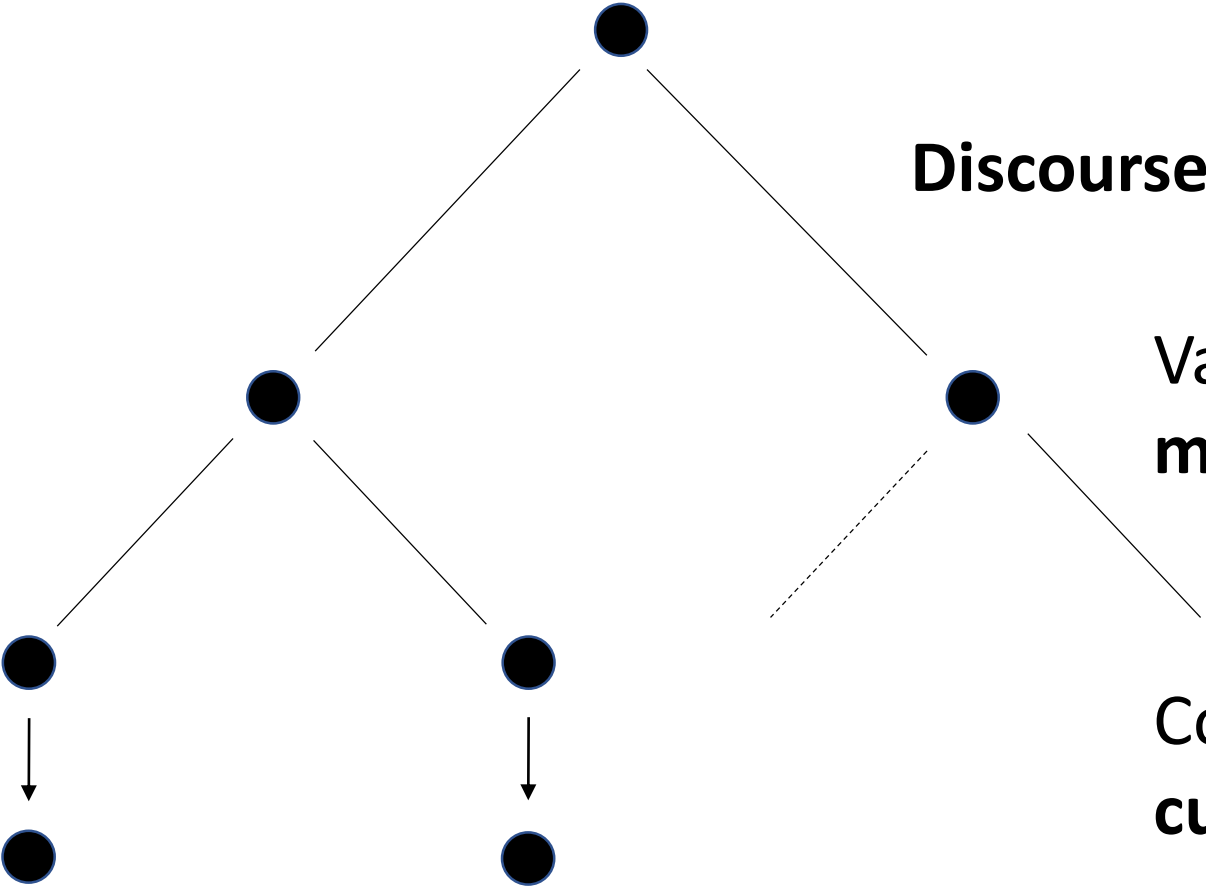


**Strategy** shift from relations  
to capital markets

**Discourse** of buyer beware

Value at Risk, weaker  
**managers**, injustice

Complex derivatives,  
**customer** losses



# How to prevent disengagement?

At Bob's trading room:

- No lucrative over-the-counter derivatives
- Risk management model data ignored
- No “subjective” bonuses
- Middle managers strictly enforced norms

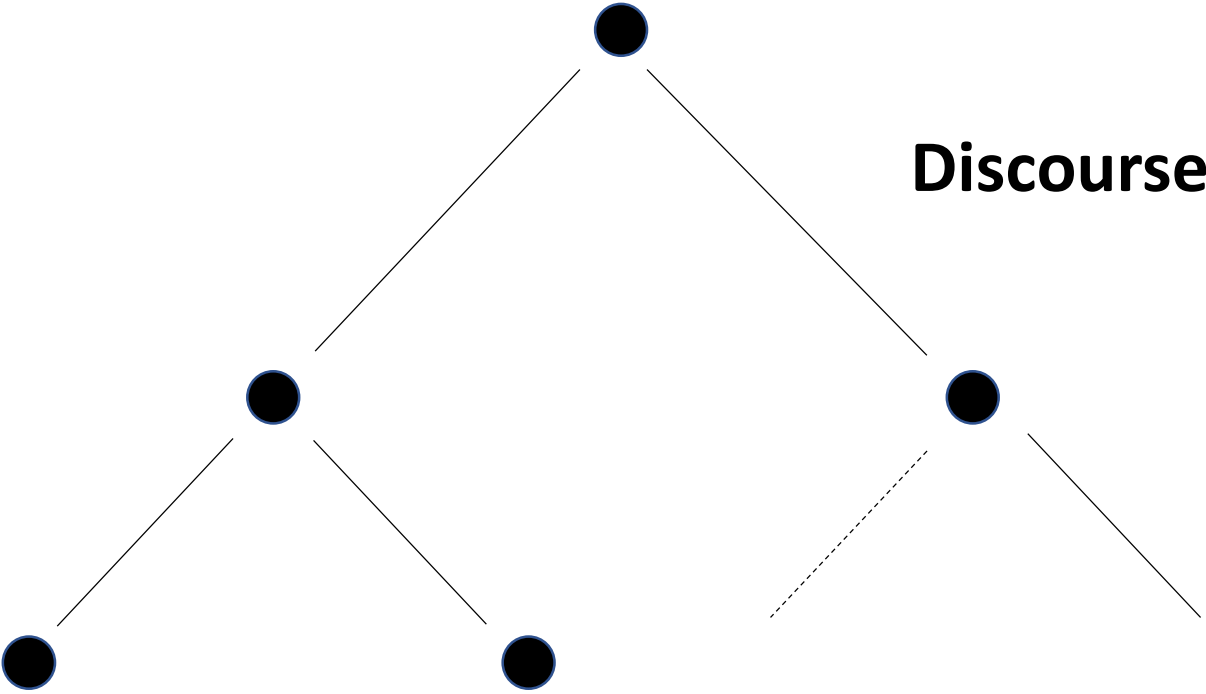
# Proximate control

- Material and discursive mechanisms that reinforce organizational norms and relations, preserving a sense of justice and sustaining self-condemnation when norms are breached
- Compatible with use of models for asset pricing, but not with the use of models to replace managers, nor with large bank size

**Strategy:** avoid business with risk of abuse

**Discourse** of responsibility

**Managerial**  
engagement,  
judgment and  
moral intuition





# Conclusion

Improving bank culture beyond symbolic promotion of organizational values calls for an understanding of how models and morals are related

Proximate control: a reorganization of the use of models in banks that addresses the moral dimension of finance

**Better management**

Thank you for your attention!

[daniel.beunza@city.ac.uk](mailto:daniel.beunza@city.ac.uk)

[www.danielbeunza.com](http://www.danielbeunza.com)

@danielbeunza

#takingthefloor