

# Webinar

## Identifying the Key Levers of Understanding and Shaping Culture and Behavioural Risk

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12<sup>th</sup> October 2018

*Disclaimer: The views presented in this session are personal views of the speaker and cannot be interpreted as any other person or organisation.*



# A. Introduction

What have these Institutions got in Common?



1905



1989



1992



WACHOVIA

1879



2007



2008

# A. Learning Objectives

- 1) What do we mean by culture and risk culture
- 2) Thinking about the changing face of managing culture and behavioural risk
- 3) Understanding how socio – psychological factors are shaping approaches to managing behavioural risk
- 4) Learning how operational risk managers can utilise these approaches in building more resilient organisations.

## A. 2008 – 2018 - A decade of Turmoil?

Why is **Risk Culture** important – let's recall

- 1) Excessive risk taking led to financial crisis 2007 – 2008
- 2) Followed by conduct risk failures

Cost of PPI - **£40 Billion** estimated provisions in July, 2018 -  
Bloomberg

- 3) Nobody is immune to conduct risk issues

The consensus is that an absence of a **strong** risk culture was at the heart of the financial crisis and conduct risk failures.

# A. Why is this Important? - Conduct Costs Project Report

Banks	Total Costs 2012-2016 [GBP Bn]	Provisions as at 31 Dec 2016 [GBP Bn]	Grand Total 2012-2016 [GBP Bn]	Grand Total 2011-2015 [GBP Bn]	[Grand Total (2012-2016)] Relative Position to [Grand Total (2011-2015)] (%)		Grand Total 2010-2014 [GBP Bn]	Grand Total 2009-2013 [GBP Bn]	Grand Total 2008-2012 [GBP Bn]
BAC	44.59	1.00	45.59	55.46	↔	-17.80%	65.03	67.25	54.70
JPMC	30.84	2.79	33.64	30.69	↔	9.62%	35.24	37.18	25.02
MS	11.48	12.89	24.36	22.01	↔	10.69%	23.61	19.59	24.96
RBS	10.48	11.03	21.51	14.74	↑ (+3)	45.97%	11.23	8.80	4.56
LBG	16.87	3.60	20.47	20.17	↓ (-1)	1.46%	15.46	12.73	9.24
CITI	15.45	2.04	17.49	18.67	↓ (-1)	-6.30%	17.34	9.47	13.26
BARC	13.18	3.87	17.05	15.43	↓ (-1)	10.48%	12.60	7.90	5.07
DB	6.78	6.64	13.42	10.67	↔	25.75%	9.38	5.62	3.94
HSBC	8.50	2.89	11.39	9.98	↔	14.08%	8.80	7.26	6.27
WFC	9.38	1.46	10.84	9.76	↔	11.03%	9.79	9.77	7.73
GS	9.25	1.46	10.71	7.66	↑ (+1)	39.82%	6.14	3.65	4.05
BNP PA	7.39	2.93	10.32	9.67	↓ (-1)	6.79%	8.19	3.55	1.90
CS	4.55	3.93	8.48	6.99	↑ (+1)	21.28%	5.87	3.56	2.98
UBS	4.06	2.59	6.65	7.40	↓ (-1)	-10.04%	6.76	5.54	26.01
NAB	2.40	1.12	3.52	3.58	↔	-1.45%	2.97	2.47	2.32
SAN	1.90	0.56	2.46	2.56	↔	-3.97%	2.76	2.72	3.63
SOC. GEN.	0.50	1.90	2.40	1.82	↑ (+1)	32.33%	1.13	0.90	1.45
CBK	1.61	0.29	1.90	1.92	↓ (-1)	-1.00%	1.96	1.37	1.19
SCB	0.83	0.08	0.91	1.00	↔	-8.26%	1.00	0.76	0.75
ING	0.61	0.30	0.91	0.78	↔	16.84%	0.76	0.85	0.95
Grand Total [GBP Bn]	200.65	63.37	264.03	250.94			246.01	210.93	199.97



# A. Why is this Important? – The Big picture

1. **Strategy implementation and risk management** need to be correctly aligned to avoid the prudential and conduct failures of the past
2. Conduct failures are putting **customer centric strategies** at the heart of firms' approaches
3. Improving overall **firm performance** is focussing on
  - i. ensuring that the **organisational culture** is supportive of the firm's strategy and
  - ii. that the **risk culture** is supportive of sound risk management



## B. So what is meant by Culture and Organisational Culture

What is meant by **Culture**?

1. *"that **complex whole** which includes knowledge, belief, art, morals, law, custom and any other capabilities and habits acquired by man (sic) as a member of society."* **E.B. Tylor**
2. Cambridge English Dictionary states that culture is, *"the way of life, especially the general customs and beliefs, of a particular group of people at a particular time."*

What is meant by **Organisational Culture**?

- 1) *"The way we do things around here"* (**M Bower 1966** - The Will to Manage: Corporate Success Through Programmed Management)
- 2) *"A pattern of shared basic assumptions learned by a group as it solved its problems... which has worked well enough to be considered valid and, therefore, taught to new members as the correct way to perceive, think and feel in relation to those problems"* (**E Schein 1992** - Organisational Culture and Leadership)

## B. So what is Risk Culture

1. Risk culture can be seen as a **subset** of the overall culture of the organisation
2. There are numerous definitions for example
  - i. “... the **norms of behaviour** for individuals and groups within an organisation that **determine the collective ability** to identify and understand, openly discuss and act on the organisations current and future risk.... FSB 2013
  - ii. “the **values, beliefs, knowledge and understanding** about risk shared by a group of people **with a common purpose**, in particular the employees of an organisation or of teams or groups within an organisation” IRM 2012
3. Excessive risk taking is regarded as a demonstration of inappropriate risk culture however excessive risk control can also be detrimental to the achievement of objectives and **what is the appropriate risk culture is very much context dependent.**
4. Risk culture is a **dynamic social process** and not just about individual aptitudes and behaviours and heavily influenced by both external and Internal factors.
5. We don't lack for models around Risk Culture!



## B. Drivers of Risk Culture - Internal Factors

1. **Risk management Function** - the status of the risk management function and employment of centralised versus decentralised model
2. **Three Lines of Defence** - how well articulated are each roles and well embedded are they in practise
3. **Risk Appetite Frameworks** - how effective are they in practise
4. **Recent Risk History** - the frequency and severity of recent risk events
5. **Nature of formal and informal organisations** - how well are the formal risk governance structures operating and what is the power and influence of the informal networks within the organisation.
6. **Incentive Structures** - excessive incentive structures can undermine risk culture through excessive risk taking

## B. Drivers of Risk Culture - External Factors

1. **Economic Conditions** – the appropriate balance between risk control and risk taking activities should be (!) heavily influenced by the economic cycle.
2. **Competition** – an argument can be made that the excessive competition lead to excessive risk taking prior to the Irish Financial crash.
3. **Technology** – the speed and intensity of events can be exacerbated by technological developments and may require a risk cultural response
4. **Stakeholders** – Meeting stakeholder's expectation can influence risk culture

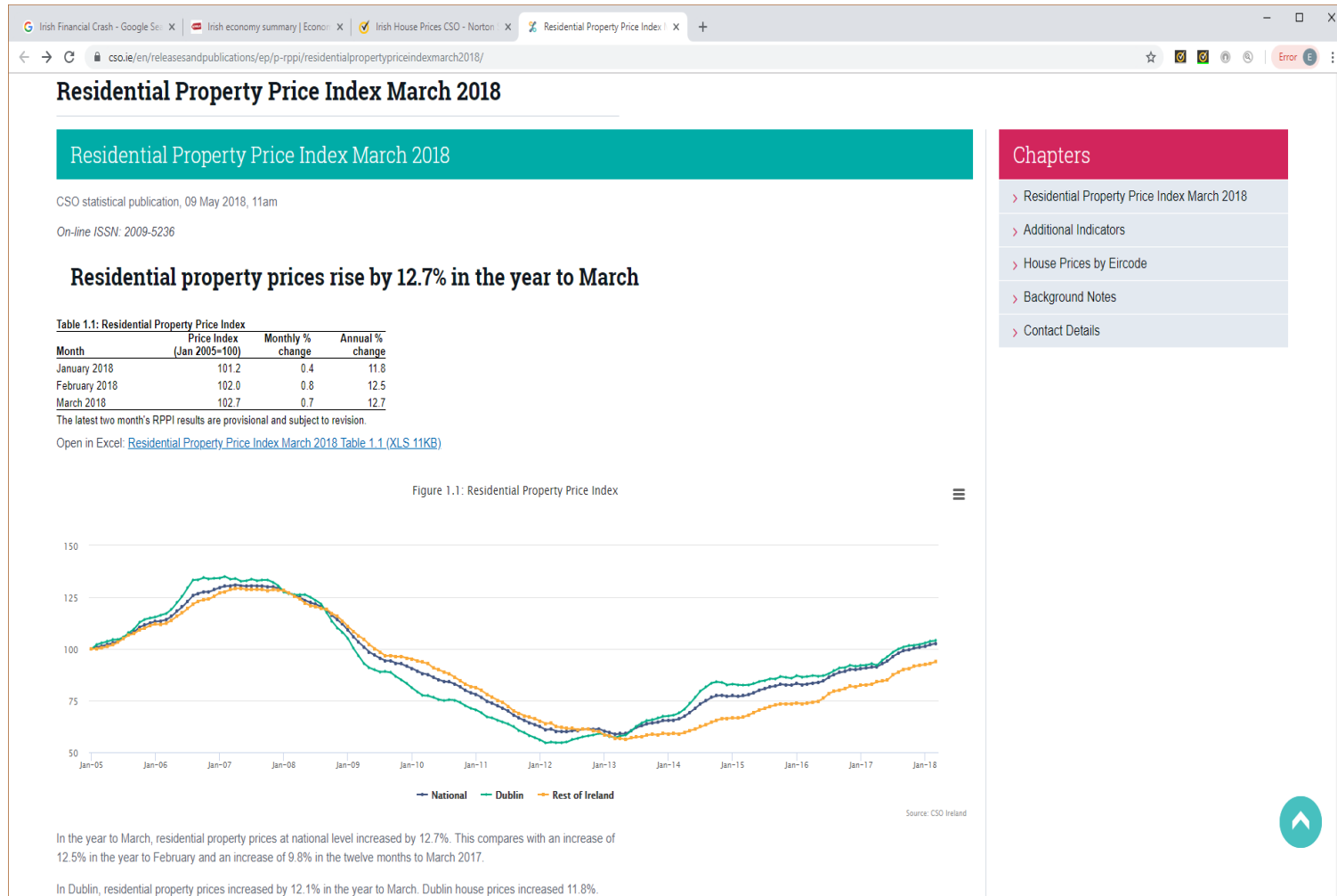
## B. Views of the Financial Stability Board on Risk Culture – Risk Culture Standard Model!



<http://www.fsb.org/wp-content/uploads/140407.pdf>

1. The **Financial Stability Board** issued guidance (2014) to supervisors as what they should be looking at when examining risk culture in financial institutions.
2. **Foundational Elements** of a Sound Risk Culture: Risk Governance; Risk Appetite ; and Compensation.
3. **Indicators of a sound Risk Culture:**
  - i. Tone from the Top;
  - ii. Accountability;
  - iii. Effective Communication and Challenge; and
  - iv. Incentives.

# C. However – Reality of World



## C. Looking for underlying Social Psychological Reasons- Example - Nyberg Report

MISJUDGING RISK: CAUSES OF THE SYSTEMIC BANKING CRISIS IN IRELAND -  
REPORT OF THE COMMISSION OF INVESTIGATION INTO THE BANKING SECTOR IN  
IRELAND – Nyberg Report.

1. Excessive risk taking across industry facilitated by  
**“Herding”**
2. Excessive risk taking within institutions facilitated by  
pervasive **“Groupthink”**

<http://www.bankinginquiry.gov.ie/Documents/Misjudging%20Risk%20-%20Causes%20of%20the%20Systemic%20Banking%20Crisis%20in%20Ireland.pdf>

## C. Looking for Other Answers – The Dutch Model

DNB's (the Dutch Central Bank) mission statement  
“seeks to safeguard **financial Stability**...”

*“ In light of that **mandate** , we must keep a close eye on anything that may put that this financial stability in jeopardy. Naturally, this includes a financial Institution's **behaviour and culture**”*

Frank Elderson – Executive Director DNB

# C. Looking for Other Answers – The Dutch Model

## Premises

1. Increasing rules and regulations is not enough – perception of being in control but limits to what can be achieved
2. Connection between behaviours and culture and public trust and ultimately financial stability – need to continually build trust and reputation
3. Behaviours and culture are part of a sound business operations - need to identify an institution-wide view and mission statement on appropriate behaviours and culture and effective processes to identify and manage behaviours and culture

Fundamental idea - poor patterns of behaviours can be a lead indicator of financial problems with organisational psychology underpinning approach.

## C. Looking for Other Answers – The Dutch Model

Figure 3.1 DNB's supervisory model on behaviour and culture

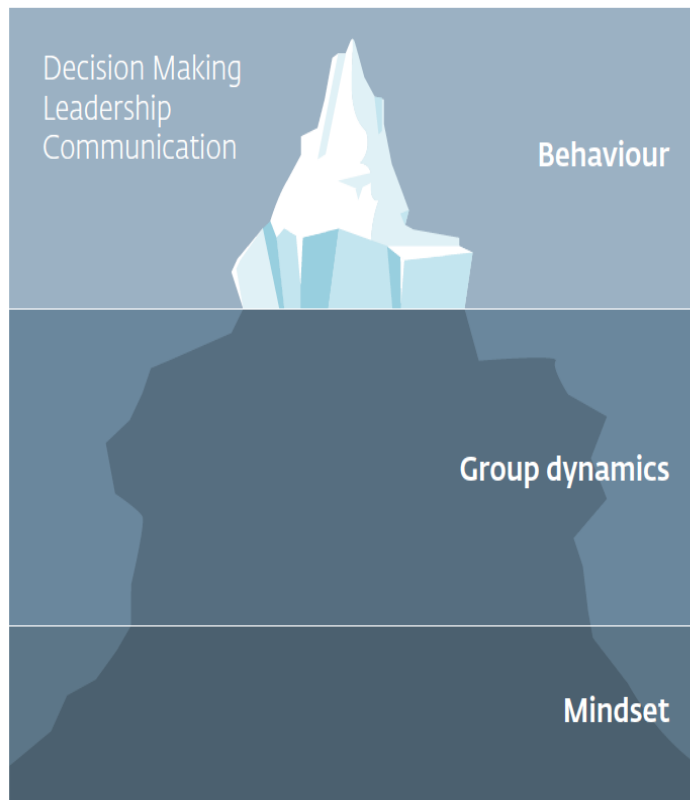
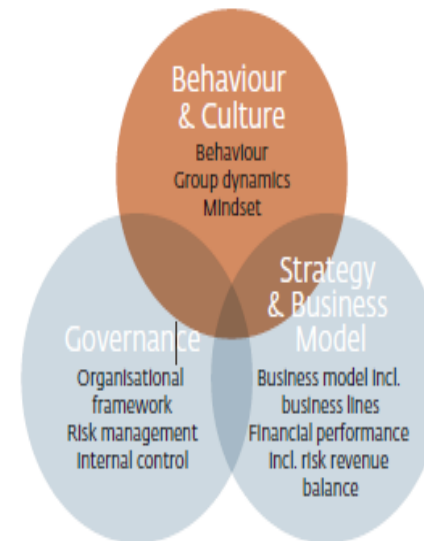


Figure 3.2 The integrative perspective on behaviour and culture, governance and strategy & business model





## C. Looking for Other Answers – The Dutch Model



### Overview

- Why This Book?

### Part I - Foundations

- The Rational for the Supervision of Behaviour and Culture
- Model and Basic Assumptions
- Supervisory Approach and Methodology

### Part II - Practise – Focus on Group effectiveness

- Decision Making
- Leadership
- Communication
- Group Dynamics

### Part II - Practise Focus on Change

- Capacity for Change
- Culture Change

### Part III – Future Developments

- Error Management in Financial Institutions
- The Way Forward for effective External Supervision is to Influence Internal Supervision

## C. Looking for Other Answers – DNB – Group Dynamics

### Made in Japan



The Japanese parliament's independent investigation committee cited the following underlying dynamics and cultural elements as contributing to the disaster

1. A lack of trust between the major players
2. A reluctance to escalate bad news
3. Aspects embedded in the national culture

“Our reflexive obedience, our reluctance to question authority, our devotion to ‘sticking to the program’, our group-ism, and our insularity .....along with a need to save face.”

(Investigation Committee report)

## C. Looking for Other Answer - DNB - Group Dynamics

One of the drivers of behaviours is **group dynamics** which can influence **decision making, leadership and communications**, therefore essential to understand and assessing group dynamics

### Assumptions

1. Relationship between **Group Dynamics and Group Effectiveness**
2. **Social Processes** in groups that underline Group Dynamics
3. **Assessment** is at moment in time and in a specific context

## **C. Looking for Other Answers - DNB - Group Dynamics**

### **Indictors for Assessing Group Dynamics**

#### **1. Group Composition**

- i. Diversity and performance of group members
- ii. Size

#### **2. Group Climate**

- i. Nature of Interpersonal Relationships
- ii. Cohesions
- iii. Dealing with Conflict
- iv. Balance Task and Relationship Orientation

#### **3. Status Differences**

- i. Looking at Dynamics between different Groups

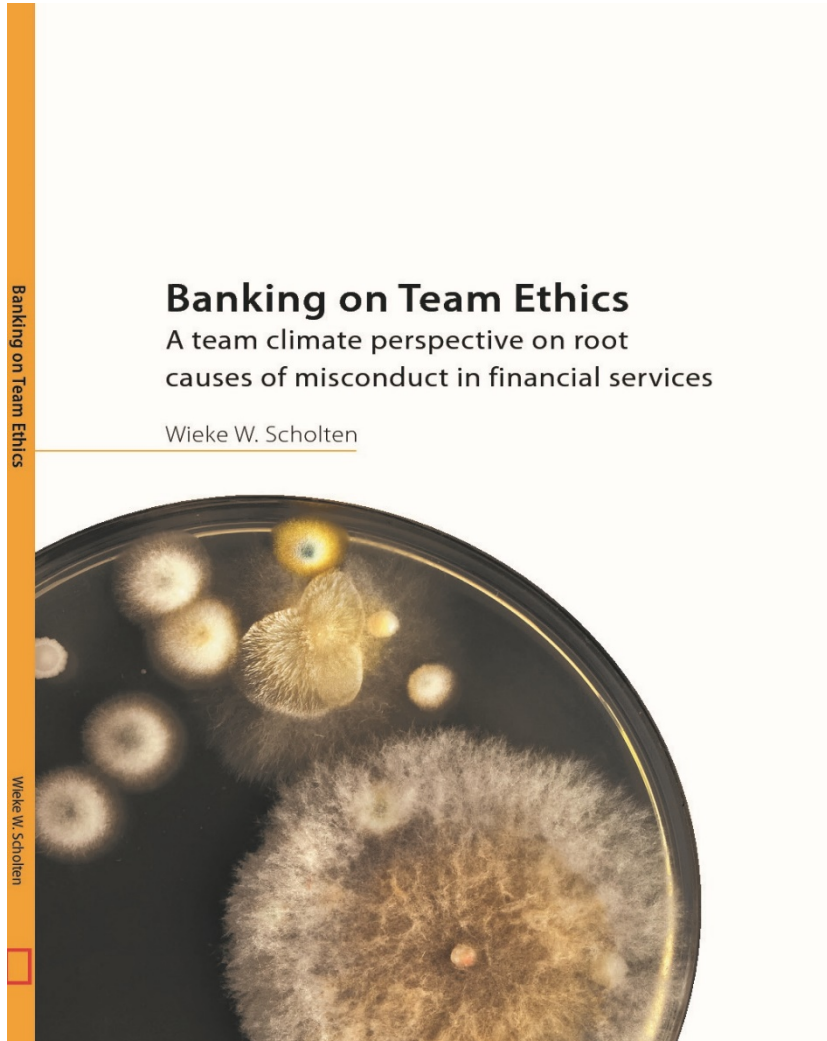
## D. Looking for Other Answers - Corrupting Barrels v Bad Apple

Focus of attention when it comes to mis-conduct has been the individual's failings.

Lets go back in time and into the field of **Criminology**.....

1. **Edwin Sutherland** in 1939 coined and defined **white-collar crime** as “an offense committed by a person of respectability and high social status in the course of his /or her occupation”
2. Developed the **differential association theory** of crime which proposes that through interaction with others, individuals learn the values, attitudes, techniques, and motives for criminal behaviour
3. As Susan Sibley (MIT) focusing on **Ethics and Ethical Training**, comments that the most important contribution Sutherland makes is his emphasises on **context and social organisation** rather than exclusive focus on **individual choice making activity**.

# D. Looking for Other Answers - Utilising a Team Climate Perspective – W. Scholten



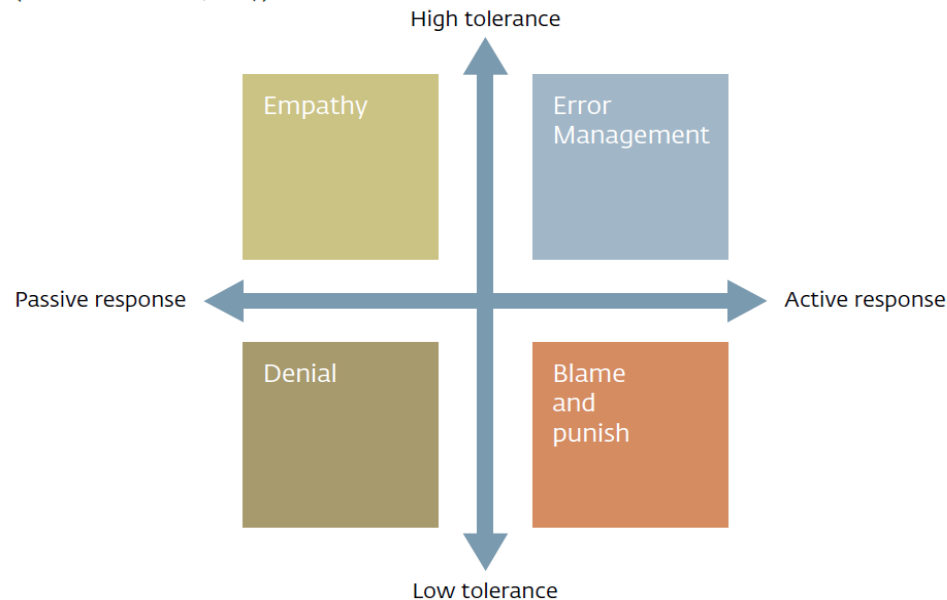
1. This book provides insights and tools for managers and external supervisors within financial services that help to **define and assess team climates** in order to prevent **future misconduct**.
2. Assessing the **Team Climate**:
  - i. Ineffective Errors Approach ?
  - ii. Outcome Inequality ?
  - iii. Dysfunctional Moral Team Climate?



## D. Looking for Other Answers - Utilising a Team Climate Perspective – W. Scholten

- The way that a team deals with task relevant errors may facilitate misconduct

Figure 11.1 Four organisational approaches to errors  
(based on Homsma, 2007).



# D. Looking for Other Answers - Utilising a Team Climate Perspective – W. Scholten

## Improving Team Climate

1. **Leadership** is key
2. Improving the “**Corrupting Barrel** “ Team Climate Characteristics
  - i. Improve Error Approach
  - ii. Reduce Outcome Inequality
  - iii. Manage Emotional consequences
  - iv. Improve Moral Climate
3. **Conflicts to Resolve**
  - i. Contradiction between a strong control environment and an openness about errors
  - ii. Contradiction between performance and compliance goals
  - iii. Contradiction between a legal and a learning approach regarding misconduct which has taken place

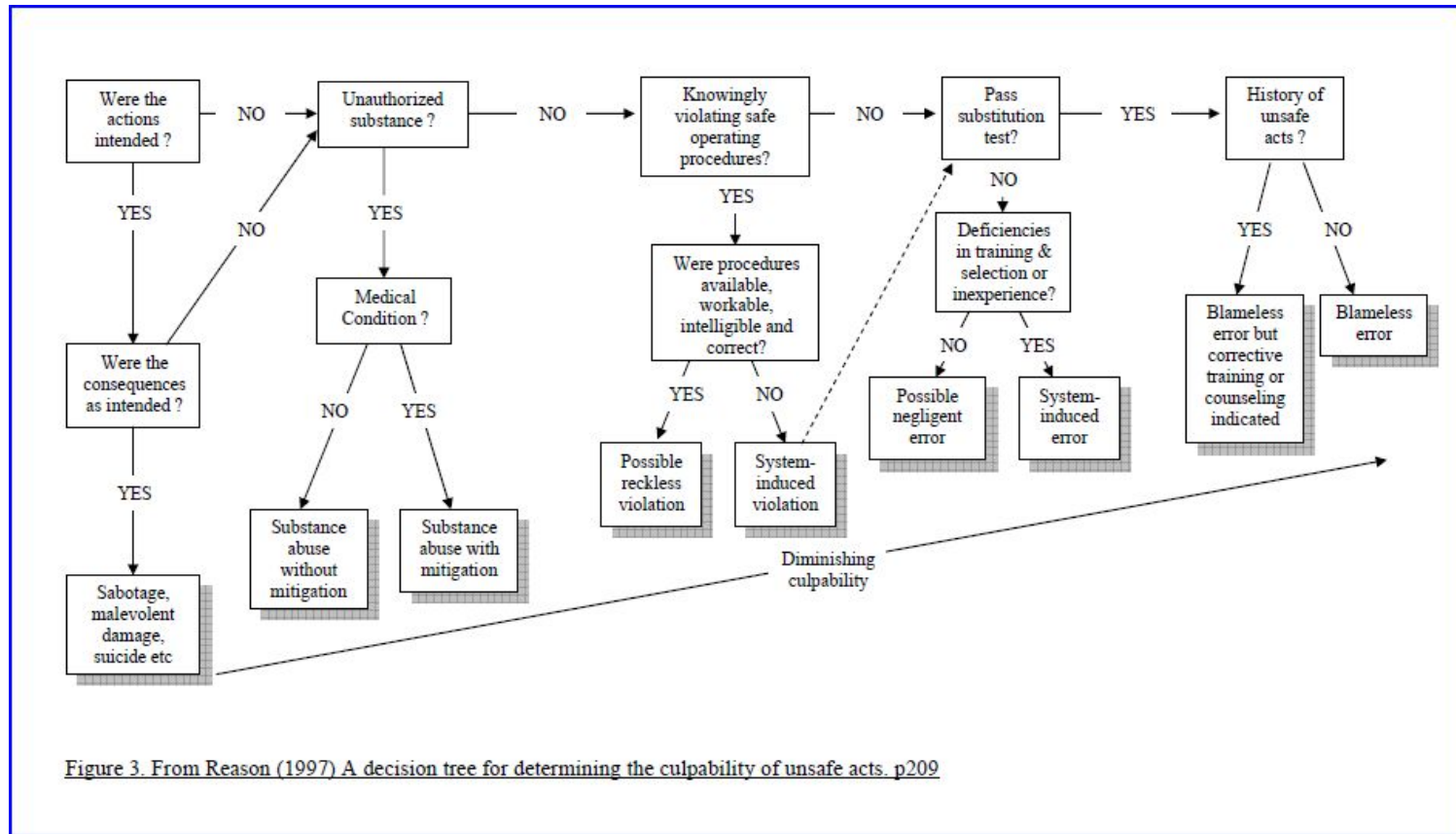


## E. Looking for Other Answers - Just Culture Approach

A fundamental element of a strong risk culture is ensuring that risk information is communicated up and down the organisation.

1. A “**blame culture**” within an organisation can inhibit this ideal but a “**no blame**” culture can have the impact of reducing accountability.
2. Other industries such the medical profession, nuclear power and aviation have been examining this issue and have developed the concept of a “Just Culture”.

## E. Looking for Other Answers - Just Culture Approach



**Final, Final Thoughts !!**

**Risk Culture Conversations - 2028**

**?**

# Questions and Comments



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