OLIVER WYMAN

Financial Services

POINT OF VIEW

GETTING TO THE HEART OF RISK CULTURE WITHIN FINANCIAL SERVICES

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“Getting back on the right path ... requires investors and financial leaders taking values as seriously as valuation, culture as seriously as capital”

*(CHRISTINE LAGARDE, MANAGING DIRECTOR - INTERNATIONAL MONETARY FUND.
SOURCE: IMF WEBSITE, SPEECH ON ECONOMIC INCLUSION AND FINANCIAL INTEGRITY PREPARED FOR THE INCLUSIVE CAPITALISM INITIATIVE CONFERENCE, 27 MAY 2014)*

1. INTRODUCTION

1.1. THE DOCTOR'S PARABLE

A patient is unwell and visits the doctor. The patient is suffering from unpleasant symptoms, hence is impatient to get relief.

The inexperienced doctor, driven by the patient's impatience, provides a treatment that lessens the symptoms. This treatment does not address the underlying cause because this is not clear to either the patient or the doctor. The patient is happy with the outcome, as they have their prescription and a 'quick fix' resolution to their symptoms. But the patient's happiness is short-lived. The long-term, underlying problem remains, and will re-emerge in time.

By contrast, the more experienced doctor recognises the need to understand the underlying cause. They recognise that symptoms are only a part of the picture and can often be ambiguous, even misleading. This doctor uses their skill and experience to select from a wide range of possible tests and techniques to test hypotheses. They pursue the right diagnosis which uncovers the underlying cause. This may take a little more time than the inexperienced doctor, and can require additional loops as certain causes are ruled out and new tests are conducted. Once the underlying cause is determined beyond reasonable doubt, the experienced doctor prescribes an effective course of treatment – a treatment that eases both the symptoms and tackles the underlying issue. With good communication, the patient does not become frustrated at the longer diagnosis phase as they grow to understand the underlying causes of their illness and the importance of the right treatment.

1.2. THE PARALLELS WITH CHANGING RISK CULTURE

In the context of organisations, corporations and institutions, poorly diagnosed or designed risk culture initiatives are akin to the inexperience doctor's approach. These programmes use superficial analysis of the symptoms and give in to demands for a quick fix approach. The result tends to be a generic action plan, which does not address or even understand the underlying cause of the risk culture issues. In concrete terms, these programmes often use only benchmarking tools for diagnosis. In taking action they focus on structural adjustments and 'sheep dip' programmes (typically communication and training sessions) through which employees are presented with new structural approaches and values. We do not believe that these programmes are effective. They do not materially shift risk culture as they do not tackle the underlying drivers – most notably behaviour. These programmes deliver short-term actions, but really little happens when it comes to shifting the organisation's underlying behavioural norms.

By contrast, more effective risk culture programmes use the approach adopted by the more experienced doctor who takes the time to understand the issues before creating the right risk culture for an organisation.

In this point of view, we explore the current state of the Financial Services risk culture and lay out more clearly the behavioural aspects of change required, including how Financial Services organisations can go about achieving these changes.

2. DEFINING RISK CULTURE

2.1. THE STATE OF RISK CULTURE IN FINANCIAL SERVICES

What is risk culture? A practical definition is that it is how individuals and teams in an organisation behave in relation to risk issues – both the day-to-day and business critical risks. Risk culture is inherently a human issue.

A mature risk culture is not a more risk averse culture. Informed risk taking is an important element for Financial Services organisations and the financial system as a whole. By contrast, a mature risk culture shapes consistent behaviours in an organisation's people around awareness, understanding, risk appetite, position-taking, and management of the risks themselves.

Risk culture is a vital part of the whole risk system, because even small, isolated pockets of poor risk culture can thwart efforts to improve management and control of risk within organisations. Without a constructive risk culture, risk management becomes heavy with processes and controls, and often in conflict with the business strategy. Even if structural risk management is good, an unsupportive risk culture is distracting, expensive and exhausting for all those involved.

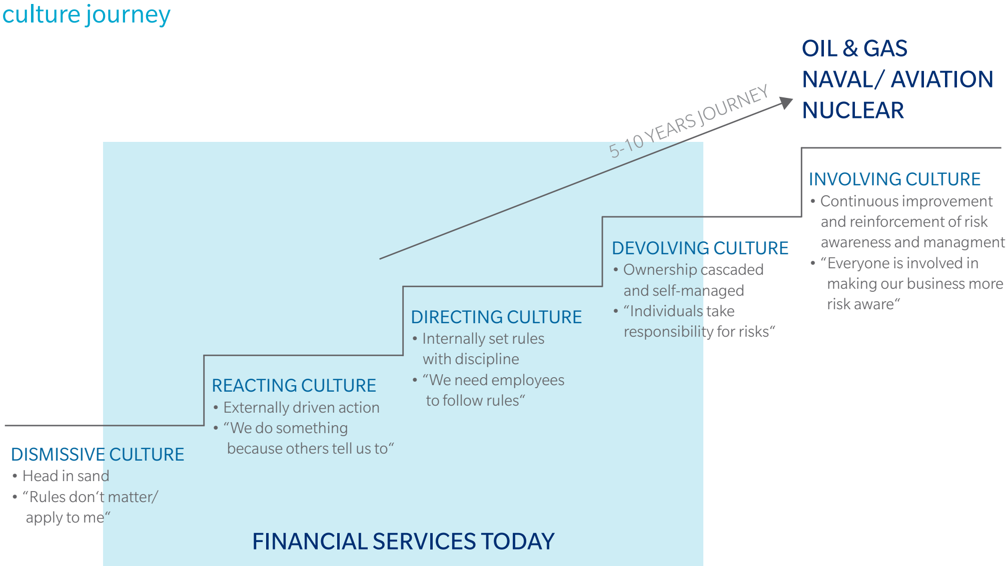
On the other hand, with a constructive risk culture, risk management efforts are supported more naturally. Responsibility for risk management becomes easier to distribute across the organisation and eventually a part of the way we work everyday. Overall, the investment in risk management becomes more effective.

Across Financial Services the state of risk culture is under scrutiny, elevating it on the agenda of the Boards of Financial Institutions who are putting significant pressure on senior management to change the way their organisations behave on risk issues.

We believe this focus is justified. Shortly after the global financial crisis we interviewed 27 companies from the Financial Services sector and compared their performance and procedures with companies in asset intensive industries such as Oil & Gas and Mining[1]. A lack of an adequate risk culture has been a significant factor in many of the recent failures in Financial Services. Across the whole sector we saw that over 60% of operational risk incidents were related to people and cultural issues, but less than 10% of mitigation initiatives relate to behaviours – a balance that needs to be rectified.

Our analysis indicates that Financial Services organisation's risk cultures are between 5 to 10 years behind similar sized organisations within asset intensive industries.

Exhibit 1: The risk culture maturity stairway – Financial Services 5 to 10 years risk culture journey



[1] **Source:** Corven: Banking on culture to manage risk (October 2012)

2.2. BUT TOO MANY INSTITUTIONS ARE ON THE WRONG PATH

We see confusion within many Boards and management teams around risk culture: What is it? What does our risk culture really look like? Can I measure it? Does it differ across the organisation? What should our risk culture be? How does it align to our business objectives? How do we change it?

Our experience shows us that too many organisations view risk culture as either something structural to fix (for example, adjusting organisation processes and compensation systems), or something that can be addressed through communication and training (for example, a programme of posters, videos, new values and training). Whilst these support the development of aspects of a risk culture, they fail to recognise that risk culture is a human issue and changing it requires both human solutions and structural changes, which in unison adjust behaviours effectively over time.

Many organisations underestimate the complex nature and relationships that exist around their risk culture, and do not appreciate that the current risk culture is resistant to change. Our behaviours are complex, varied and habitual, and therefore risk culture is both difficult to diagnose, and self-reinforcing. The science of unconscious biases helps make the case as to why this is so. Our behaviour is influenced by those that are like us (belonging); others in the group (herding); authority (trusting); and data that supports our current views or the established views of our organisation (confirming). These are all natural tendencies, and are all very human. They affect all of us, often unconsciously, and reinforce the current behavioural norms.

For Financial Services organisations that are attempting to move to a more mature risk culture, our experience shows that the right path is one that focuses on understanding and then changing behaviours from within, rather than structural changes and ‘sheep dip’ programmes. We would stress the importance of the behaviours of an organisation’s leaders from CEO to individual team leaders. Getting the right behaviours sustained by these leaders is critical to ensuring sustained change across the organisation.

3. DIAGNOSIS – HOW TO ANALYSE RISK CULTURE

Before deciding what needs to be done, organisations must first understand how the current risk culture is manifested in the behaviours of their people, what is reinforcing the current risk culture, and how they will know when the right risk culture has been created. Much as a doctor would, there are an array of assessments and tools across a number of themes, to comprehensively diagnose the situation.

Standard tools and techniques include:

DIAGNOSTIC AREA	TOOLS AND TESTS (TYPICAL EXAMPLES)	OUTPUT
Behavioural Analytics	☑ Leaders behavioural assessment ☑ Review of existing staff engagement surveys and 360 feedback ☑ Risk culture survey for a cross-section of the organisation ☑ Analysis of behaviours that led to past failures and understanding the drivers ☑ Structured observation of critical meetings and operations ☑ Mapping of the leaders' formal and informal impact – mapping both degree of impact and span of influence	• Shows the status quo of how current risk culture manifests in the organisation • Demonstrates how it differs across the organisation and the different groupings • Provides input to enable prioritisation and a benchmark of the current risk culture to track against • Provides detail on how group dynamics operate and where biases may be helping and hindering change
Structural Assessment	☑ Review of: • *Governance/decision forums and authorities* • *Reward and compensation structures/enforcement/ penalties* • *Reporting and monitoring content and impact* • *Appraisal and feedback structures* • *Staff training and development* • *Promotions, hiring and on-boarding* • *Internal and external communication* ☑ Past failure 'structures' analysis – tracing back symptoms through the lens of the current operating model (structure, process, procedures, policies, roles, information, etc.) ☑ Focus group sessions with small groups of mid-level staff to help refine the insights gained in both the Behavioural Analytics and Structural Assessment	• Shows the ecosystem that supports the existing organisation and risk culture • Highlights imbalances between behaviours and structures • Provides input on important structural elements to adjust and nurture new behavioural norms improving the risk culture and performance • Highlights real life case studies and stories, enabling senior management to see where reality may not align with their perceptions
Future State Assessment	☑ Articulation of desired future risk culture alongside the business strategy and vision ☑ Test of risk culture measurability	• Shows the end goal for risk culture and definition of a healthy risk culture (or not) for the organisation to measure and monitor progress • Helps leaders debate the challenging issues around how risk culture sits alongside business strategy (for example short-term results vs long-term business risks) • Starts the process of mind-set change within leaders in terms of engaging them with the end vision • Identifies measures and metrics to monitor progress

We are not suggesting that all the tools in each part of the toolbox should be used in all circumstances. However, our experience shows that elements from all three diagnostic areas are important to include. Without this, it is highly likely that the interventions will not be optimal – in fact, poorly coordinated actions may contradict or undermine each other.

One clear observation we have made is that too few organisations use behavioural analytics tools in diagnosing their current risk culture. These are vital as the underlying behaviours are the demonstration of culture in action. We recommend focusing on behaviours rather than focusing a lot of effort on perceptions of values, which are harder to change and less tangible.

The added benefit of this diagnostic approach is that leaders will gain a much clearer view of the status quo, the drivers and the vision for the future – these in themselves make driving change more effective.

CASE STUDY 1*

BEHAVIOURAL ANALYTICS IN DIAGNOSTIC PHASE THAT DRIVE CHANGE AT AN INDIVIDUAL AND TEAM LEVEL

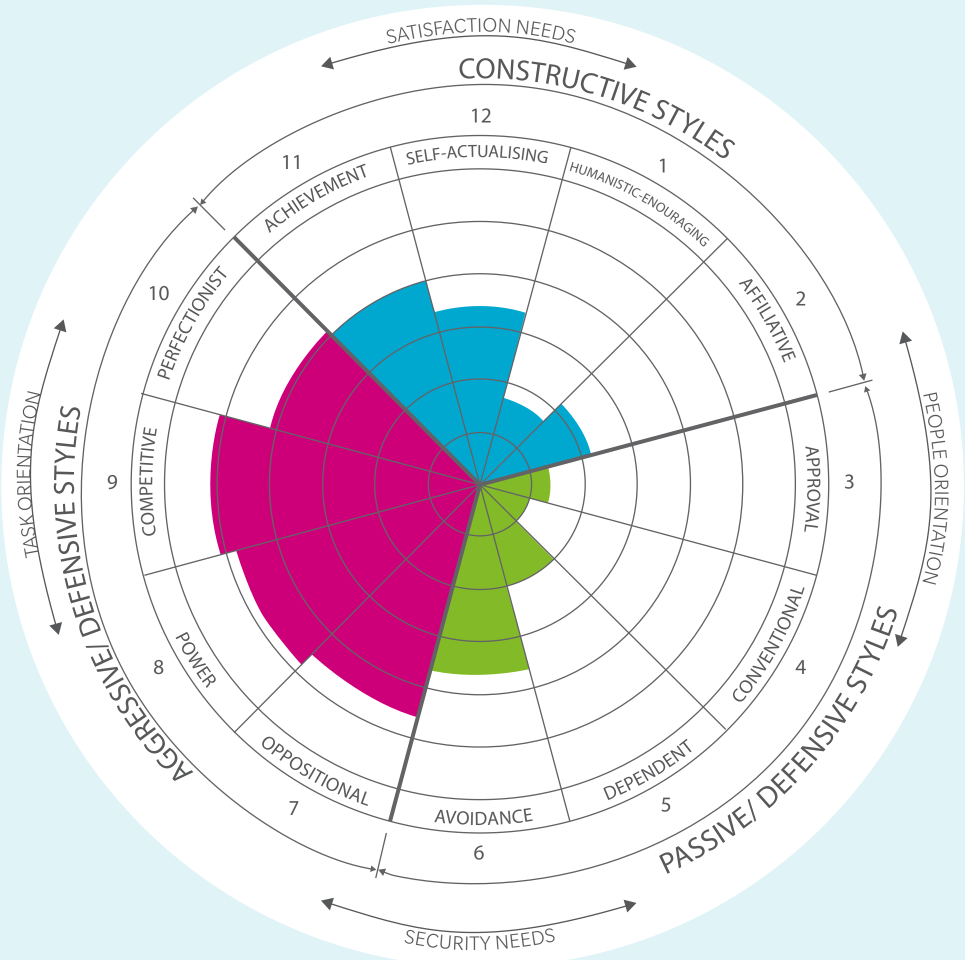
In this programme we supported an organisation with 60,000 employees to identify and change elements of their culture via behavioural interventions.

Through the diagnostic phase we identified the desired behaviours, as well as, the leaders and individuals that would drive the change in behaviour.

Here we take a detailed look at one of the many individuals in the programme and their behavioural impact.

A very successful individual that leads the Operations Division and was known as 'The Silver Back' – he trusted his gut and in the majority of cases was right. He struggled to fully articulate his ideas and believed he was surrounded by idiots as no-one contributed to discussions. He found himself often yelling at people to get things done, some saw him as a bit of a bully, but he did deliver results. In this case we used the Human Synergystics *Life Styles Inventory*™ (LSI) to diagnose and map his behaviours (see exhibit 2).

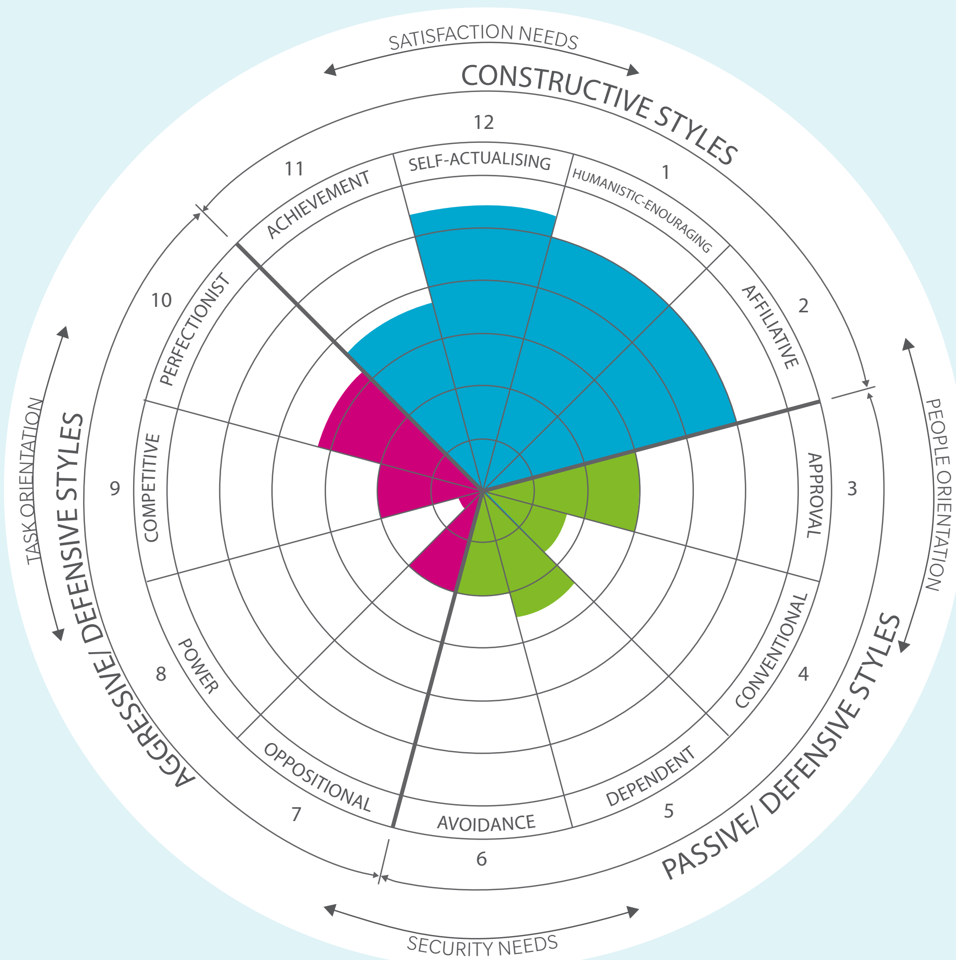
Exhibit 2: Before©



This analysis showed the high levels of aggressive behaviours and lack of development both of himself and others in his team. This led to knock on behaviours and set some of the cultural tone in the division. It also became clear that many of his behaviours were not consistent with the agreed future state behaviours.

This diagnosis tool provided a starting point for a series of behavioural changes over a period of 18 months. Working together with him and his team he dramatically changed his behavioural styles with a resulting impact on the culture in the division. He listens, seeks peoples' views, considers the impact he might have in meetings before speaking, and is able to use data to support his gut feelings. One of the team members involved at the start of the programme went on extended leave. On their return they were amazed at the change. Exhibit 3 shows the final profile for this leader and the behavioural shift achieved.

Exhibit 3: After©



Research & Development by: J. Clayton Lafferty, Ph. D. Copyright ©1987-2014 by Human Synergistics International. All Right Reserved.

* *Life Style Inventory* ™ (LSI) and the LSI Circumplex are trademarks of and copyrighted by Human Synergistics International. All Rights Reserved.

4. TREATMENT – HOW TO CHANGE RISK CULTURE

Too many risk culture change programmes focus primarily on making structural adjustments in the organisation. They change reporting lines, compensation, year-end review forms, policies and other elements of the ecosystem. They then typically roll out a 'sheep dip' programme. The rationale is that these actions are sufficient to kick-start change in an organisation's risk culture. We disagree. In our experience these programmes have a temporary benefit. In many cases, they do little more than provide a short-term illusion of action and in the worst case deliver cultural change fatigue. Changes are embedded on paper only, not in behaviours.

We recommend leading with behavioural interventions to embed a more mature risk culture, supported by a coordinated programme of structural changes. We also believe that a sustained effort is required to transition these into behavioural change.

4.1. A SHORT ANATOMY OF BEHAVIOURAL INTERVENTIONS

An effective behavioural change approach uses a programme of planned waves. Each wave is typically 90 days, creates changes in behaviours and achieves the associated business impact.

This approach ensures that the impact of the first wave of change informs what needs to be amplified or adjusted in the next wave. For those leading the change in risk culture, we believe that it is important to recognise that behavioural change interventions are not linear like many structural changes. Instead it is a process of interlinked behavioural adjustments across many groups and individuals. Although each wave of interventions will, and should, have a measurable impact upon the culture if done correctly, this change will sometimes move in an unpredicted manner. These learning loops and a commitment to running multiple waves are therefore important.

The behavioural interventions should be focused on specific target groups and address defined behaviours. They will be based upon the data and insights gained in the diagnostic phase, and be tailored to each individual or group. The interventions are typically delivered via a number of forms, including:

- Working sessions and workshops
- Visits and experiences
- Support and coaching
- Pilots
- Peer feedback and action based reviews
- Consistent communications

These actions need to be carefully designed as the detail is important if they are to be effective. In designing these, we recommend drawing from techniques that rely upon insights around how professionals learn new behaviours and establish new neural networks. We have found that the most effective tools apply some of the latest thinking from research in neural science, neuro-linguistic programming techniques and behavioural change. Many of these activities nudge behaviours by influencing them at both a conscious level (where many programmes focus) and a subconscious level (where most behavioural change occurs).

Many people believe that such change should always start at the top, based upon the assumption that the behaviour of the hierarchy mirrors perfectly the impact of a leader's behaviour. Our experience shows that the impact of leaders' behaviours is rarely an exact mirror. A critical part of our assessment identifies which leaders have a bigger impact on the current organisation and we recommend that they are included in the first wave.

Over time, as leaders demonstrate new behaviours which are sustained, this does have a positive ripple affect across the business with others then emulating behaviours and modifying them to suit their working environment. To ensure there is a sufficient level of consistency across the organisation, a subsequent wave of change would typically be used to shape how teams and individuals emulate their leaders.

In addition to role modelling behaviours, both formal and informal communication supports the change, and helps use authority bias and group dynamics to precipitate changes in behavioural habits. As well as the normal corporate change communications, targeted and at times provocative communications can be used to help nudge people and get them thinking about the change in their day-to-day working environment.

CASE STUDY 2

A TYPICAL BEHAVIOURAL INTERVENTION PROGRAMME

The Board of a global Financial Services organisation asked us to support the change of their culture to one with greater transparency, support and challenge. This programme was developed for the top three layers of leadership to help develop and support them in shifting the organisation.

We implemented three 90-day waves of change; each focused on a distinct aspect of the desired cultural change:

- Wave I: Focused on the behaviours required at an individual level to become a more resilient leader who is better able to deal with change and risk, including areas such as building self-belief, managing contentious situations, trusted advisor conversations, and performing under pressure
- Wave II: Focused on inter and intra team dynamics and how they could improve the level of transparency, trust and collaboration across the holding company and its divisions
- Wave III: Focused on the organisational and structural changes needed to support the new culture and way of working, creating a highly resilient organisation with changes in learning and development, governance and staffing

The impact of the change was demonstrated in the re-running of the behavioural analytics used in the initial diagnostics – 80% of the leaders were much closer to the ideal behavioural pattern. Feedback within the organisation was very positive with evidence of an accelerated change.

4.2. STRUCTURAL CHANGES TO REBUILD THE ECOSYSTEM

In parallel with the behavioural changes, work must be undertaken to ensure that the structural elements of the organisation (such as performance management and incentive frameworks, promotion processes, policies, controls, and rules and guidelines) are aligned with the new risk culture. The good work being done to gradually change behaviours will be quickly undermined if compensation frameworks still incentivise the wrong behaviours, or if risk policies are insufficiently clear or comprehensive. The structural drivers that are often adjusted and improved include:

- **Articulation and communication of mission, strategy, values and risk appetite.** Communications should be clear and consistent, so that staff understand how the organisation's goals and values apply to them and help translate these into changes in their daily actions
- **Organisational structure and governance.** The formal structures people work within (for example, reporting lines, committees, role descriptions, decision rights, delegated authority, key decision processes, etc.) need to support the desired culture
- **Policies, training, processes, tools and data.** Policies and procedures should be clear, comprehensive and consistent, communicated and accessible to relevant staff, so that no one can claim that they are not aware of the rules. Processes with clear roles, responsibilities and deadlines reduce conflicts and frustrations. Robust tools and data are required to enable the rapid identification and escalation of issues
- **Performance management, targets, incentives and enforcement.** Aligning personal, team and group targets and incentives with cultural values, rewards the desired behaviour. Setting, communicating and enforcing meaningful and proportionate penalties for risk or compliance breaches discourages bad behaviours. However, ambiguous and an overly long list of targets can be counterproductive
- **Employee hiring, direction and development.** A high performance and risk mindful culture helps attract, grow and retain talented staff, reinforcing business success and risk awareness. Cultural messages and priorities therefore need to be embedded in key HR processes such as recruitment, on-boarding, training, succession planning, and promotions
- **Structural controls.** Even institutions with a very robust risk culture cannot dispense with structural risk controls entirely. Accidents will happen, human error will occur, honest mistakes will be made and the occasional 'bad egg' employee will pop up now and then. Therefore, a robust structural control framework (limits, policies, restrictions, rules, monitoring, and controls) goes hand-in-hand with a strong risk culture to ensure risk-taking remains within appetite

This in itself can amount to a material effort, requiring careful review of the organisation's policies, processes and frameworks to identify and address inconsistencies. This can be especially challenging when sensitive topics such as compensation are involved.

These changes play a critical supporting role. They ensure that structures are created that are consistent with and will reinforce, and not undermine, the new risk culture over a sustained period of time.

4.3. CHECK-UPS – HOW TO KNOW WE ARE MAKING PROGRESS

Although organisations may agree on the desired end state with respect to the risk culture, the starting points and duration of the journey varies from under a year to five years. Changing risk culture takes time, effort and skill over a sustained period, to rewire behaviours that have been built and reinforced over many years.

Hence, when undertaking a critical programme which touches the entire organisation, it is vital that monitoring is robust. Progress needs to be measurable with achievements recorded each quarter.

Fortunately, the behavioural analytics diagnostic tools provide suitable options for measuring progress against the risk culture goal. Changes in core behaviours, comparisons between different teams, and leadership impact also provide measures of progress and insights to help refocus future waves of change.

Leading organisations regularly track key risk culture indicators and incorporate them into senior management risk reporting. In addition to the behavioural analytics metrics, proxy indicators such as staff turnover, risk limit and compliance breaches, and percentage of staff completing risk and compliance training, can be leading indicators of risk culture problems – especially if granular reporting permits the identification of pockets of inconsistent risk culture.

Monitoring efforts can be particularly, though not exclusively, concentrated on areas previously raising concerns, or where there are other high-risk characteristics such as new business units, fast growing or remote businesses, and uptick in key risk indicators.

5. THE DOCTOR’S ADVICE

Understanding and changing risk culture is not natural for many financial services organisations. It requires greater insight into culture and behaviour, the development of new skills, and sustained effort and monitoring at all levels. If done effectively, it will build a new self-reinforcing set of behaviours that cements a more mature risk culture of risk taking and it will drive business performance.

“Culture is what people do when no-one is looking”

(HERB KELLEHER, CO-FOUNDER AND FORMER CEO SOUTHWEST AIRLINES)

Oliver Wyman is a global leader in management consulting that combines deep industry knowledge with specialised expertise in strategy, operations, risk management, and organisation transformation.

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