RISK CULTURE: NO SILVER BULLET

MORE WOMEN ON THE TRADING FLOOR IS NOT THE ANSWER FOR IMPROVING RISK CULTURE

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WHAT CAUSED THE FINANCIAL CRISIS?

Many answers have been offered. One that has proved popular with the media is that too many senior bankers and trading room staff are men. Lehman Brothers would have fared better if it had been Lehman Sisters.

Nor is the idea popular only with journalists. For example, the UK Parliamentary Commission on Banking Standards has said that "More women on the trading floor would be beneficial for banks. The main UK-based banks should publish the gender breakdown of their trading operations and, where there is a significant imbalance, what they are going to do to address the issue ..."[1] European Union regulators have also claimed that banking would have a better "risk culture" if more of those working in it were women[2].

As an advisor to financial services firms, a specialist on culture in Wholesale Banking and a woman, I can tell you that the issue is not so simple. Creating a culture of responsible risk-taking is a complex challenge. No single answer, such as "More women!" will suffice.

Diversity in a firm's workforce helps to avoid "groupthink" and thereby improves its risk culture. But diversity is not a panacea. As this article explains, true diversity is just part of a more comprehensive approach that banks should take to creating a responsible risk culture.

WOULD MORE WOMEN MEAN LESS RISK?

The idea that increasing the number of women in banking would reduce risk has two main justifications. The first is that some academic research finds women to be generally more risk averse than men[3]. The second is that diverse groups are less inclined towards "groupthink", more likely to identify a wide range of risks and, thus, likely to make better decisions.

From these observations, many find it a small step to the conclusion that increasing the proportion of senior managers and dealing room staff who are women would create a more responsible risk culture at banks. In fact, it is big step. Much more is required to arrive at the conclusion that more women would mean less risk.

First, the idea that women are generally more risk-averse than men is subject to doubt. As mentioned, some academic papers support the thesis but others undermine it[4]. Despite the popularity of the idea in the media, the academic jury is still out. The views of the Senior Executives and FS professionals we have interviewed for this report are also inconclusive: some feel that their female colleagues often have another approach towards risk compared to men but others think that in terms of risk appetite there is no clear difference at all.

"Women generally tend to be more thoughtful in risk taking, not necessarily more risk averse"

Euleen Goh, Chairman of Singapore International Foundation and Board member at DBS Group Holdings Ltd, CapitaLand Ltd, SATS Ltd, Royal Dutch Shell plc and former CEO of Standard Chartered Bank Singapore

"Women are far more trusting of their own decisions and intuition, therefore are not afraid of calculated risk taking"

Jenny Knott, Strategic Advisor to Group CEOs, Standard Bank Plc

"I wouldn't say that there is any difference in risk aversion between men and women. I think it's quite equal in that perspective"

Gunnar Palme, Chairman of the Supervisory Board of Skandia Mutual Life Insurance Co.

1 UK parliamentary Commission on Banking Standards "Changing banking for Good", Volume 2, article 769.

2 DIRECTIVE 2014/65/EU OF THE EUROPEAN PARLIAMENT AND OF THE COUNCIL of 15 May 2014, Article53

3 National Bureau of Economic Research, 2009, Working paper 14713, L. Borghans, B. H.H. Golsteyn, J J. Heckman, H. Meijers, "Gender differences in risk aversion and ambiguity aversion".

4 Beckmann and Menkhoff (2008), "Will women be women? Analyzing the gender difference among financial experts".

Global Development and Environment Institute, working paper no. 12-05, J. A. Nelson (2012), "Are Women Really More Risk-Averse than Men?"

A. Hibbert, E. Lawerence, A. Prakash (2008), "Are women more risk-averse than men?"

Journal of Financial Research 26 (1), 1–18. (2003), Atkinson, S. M., S. B. Baird, and M. B. Frye, "Do female mutual fund managers manage differently?"

Second, there is no reason to assume that women who get to the top in banking or who succeed on the trading floor will resemble the average or stereotypical woman. As our interviewees pointed out, women who work on trading floors tend to be anything but average. Indeed, one senior executive pointed out that they had known "plenty of crazy, irresponsible risk-taking female traders" in their time!

The same point applies to avoiding groupthink through diversity. The diversity required is diversity in outlook, temperament, experience and education: in short, diversity of thought. "All women" is a large group and hence a diverse bunch, and so are men. There are billions of women and billions of men but only tens of thousands of people who work in risk-taking roles at banks. So there is no reason to assume that the atypical women who are drawn to work in these roles, and who are hired or promoted to occupy them, will have habits of thought that differ much from their (slightly less) atypical male colleagues.

Finally, a minority will be unable to change an organization's culture. And women are likely to remain a minority in risk-taking roles at banks. Women traders may simply be regarded as "the cautious ones in the corner" while the men continue to set the overall tone.

In short, simply increasing the number of women in senior positions and dealing rooms is unlikely to create the desired risk culture. Risk culture is too complex to be amenable to any such simple solution and thinking that it would, might delay the other key actions which are needed to improve the situation.

"If it were true that women on Boards never take risks or are more risk averse, I can't see how businesses driven by women would succeed. And yet they do."

Jane Barker, Chairman of the Board, Mercer UK

"If you had more diversity then you might have taken control of some of the more extreme views in a better way. But it is the diversity which is key, not just adding women"

Jane Fraser, CEO of Citi's U.S. Consumer and Commercial Banking and CitiMortgage

RISK CULTURE IS MULTIFACETED

A bank's risk culture arises from many influences. These include recruitment, training, incentive schemes, internal risk management practices, the external legal and regulatory environment, the behavior of competitors and the sophistication and expectations of customers, counterparties and investors. These influences may pull staff in different directions and only some are under the direct control of the bank's senior management.

Increasing the number of women in risk-taking roles can play a part in improving a bank's risk culture but it will only amount to a small change and is one of many relevant factors. To drive cultural change at banks, senior managers should take five interconnected steps. Hiring or promoting more women is consistent with each of them but it cannot suffice or substitute for them.

1. **Set the tone from the top:** Senior managers, right up to CEO level, have a critically important role in influencing a bank's risk culture. This requires them to engage with the issue, which few did before the crisis but most do now. Senior managers must communicate the desired approach towards risk-taking across the bank, including the value of diversity in managing risk, not simply through the policies adopted and messages sent to staff but through the example they themselves set.

2. **Be clear about expectations:** Translate cultural values into clear expectations for behavior. Staff must know what is and is not acceptable within the bounds of the desired culture. No "boys will be boys" or similar excuses should get people off the hook. Nor should good revenue performance. Nothing better communicates management's seriousness about risk culture than dismissing or disciplining a high earning transgressor.

3. **Make sure staff are "living the values":** Clarity about expectations is not enough. Actual behavior among risk-takers must be monitored so that senior management can be confident they are "living the values". To encourage transparency, staff must feel listened to and supported when raising cultural concerns.

4. **Align incentives:** The way employees are paid – and, most obviously, the way their bonuses are determined – must reinforce the desired risk culture. This goes well beyond the standard risk-adjustment of revenues generated by risk-takers. Variable compensation should be adjusted for conformity to the desired risk culture, perhaps measured by a behavioral scorecard.

5. **Recognise the limits of culture:** An organization with a sound culture can nevertheless contain individuals who fail to conform to it. Indeed, a sound culture creates opportunities for some of its members to "free ride". For example, it is easier to enter into fraudulent transactions when you represent a bank with a reputation for honesty. This means that success in creating the desired risk culture will not obviate the need for continued vigilance towards the inescapable risk of rogue behavior or simple sloppiness.

Cultures cannot be changed overnight. The idea that a responsible risk culture can be achieved simply by employing more women is a dangerous delusion. A healthy risk culture depends on much more than the ratio of men to women. Add women to a bank where senior managers send the wrong messages, where misconduct goes unpunished and where variable compensation rewards irresponsible risk-taking, and you will still have a bad risk culture.

To reform their risk-cultures banks require long-term programs led by respected senior executives. Change may be slow but, done this way, it should be systemic and sustainable. It's not sexy but it works.