

Centre for Risk Studies

Aspen Critical Issues and Risk Forum

Risk Culture in Firms: Exemplars from the Financial Sector

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Challenges to Financial Sector

Objective: Society's financiers enabling individuals & enterprises

- Changes to risk vs reward weights
- Threats to business models
- Interconnectivity and complexity
- Increasing regulation: Dodd Frank, capital requirements

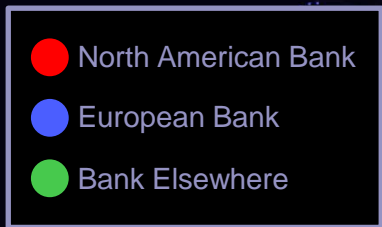
Expanded Responsibilities of the Chief Risk Officer (CRO)



- Credit
- Market
- *Operational*
- *Regulatory*
- *Cyber-security*
- *Reputation*
- *Financial crime*

How does the board maximise the value of “Risk Frameworks” in helping to navigate through complex landscapes?

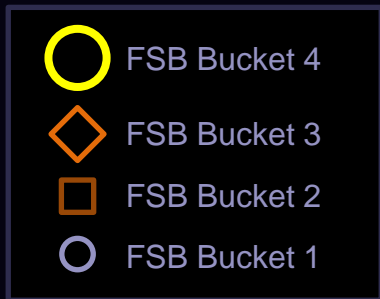
Centre for Risk Studies Network Model of Financial System



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Global Systemically Important Banks (GSIBS)

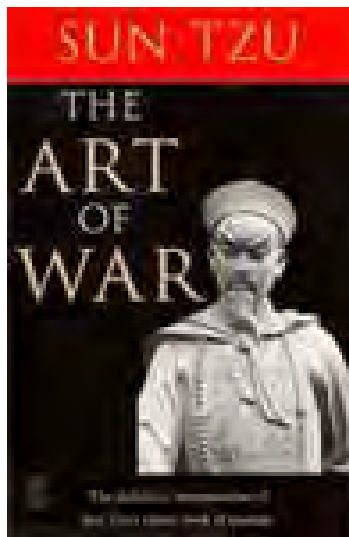
Star-finder guide



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Risk Culture vs Organisational Culture

Organisational Culture – Organisational culture work emphasises "values, norms & ethics." [Schein 2010] [Cameron & Quinn 2011]



Hypothesis: Risk Culture is Distinct

Reference	Definition
Pettigrew, 1979	"In order for people to function within any given setting, they must have a continuing sense of what that reality is all about in order to be acted upon. Culture is the system of such publicly and collectively accepted meanings operating for a given group at a given time ... The offspring of the concept of culture are symbol, language, ideology, belief, ritual, and myth." (p. 574)
O'Reilly and Chatman, 1986	"A system of shared values (that define what is important) and norms that define appropriate attitudes and behaviors for organisational members (how to feel and behave)." (p. 160).
Kunda, 1992	"When applied to organisational settings, culture is generally viewed as the shared rules governing cognitive and affective aspects of membership in an organisation, and the means whereby they are shaped and expressed." (p. 8)
Alvesson, 2002	"Culture is not primarily 'inside' people's heads, but somewhere 'between' the heads of a group of people where symbols and meanings are publicly expressed, e.g. in work group interactions, in board meetings but also in material objects." (p. 3-4)
Schein, 2010 [1985]	"The culture of a group can now be defined as a pattern of shared basic assumptions learned by a group as it solved its problems of external adaptation and internal integration, which has worked well enough to be considered valid and, therefore, to be taught to new members as the correct way to perceive, think, and feel in relation to those problems" (p. 18)
Cameron and Quinn, 2011	"An organisation' s culture is reflected by what is valued, the dominant leadership styles, the language and symbols, the procedures and routines, and the definitions of success that make an organisation unique." (p. 22)

Source: Powers et al

Image Source: Google Images

“Risk Culture” – Does Your Board Know?

How does your board define *Risk Culture*? E.g.

- ❑ Organisational culture elements that support risk based decisions
- ❑ Firm-wide understanding, embracement, and adoption of compliance rules
- ❑ Culture of “doing the right thing” vs “doing what it takes”
- ❑ Common framework for understanding and assessing risk exposures, likelihood, impact, reputation i.e. Technicals
- ❑ “Tone at the Top” – culture defined by leadership
- ❑ Ethics based definition focussed on code of conduct
- ❑ Remuneration and incentive structures to promote responsible risk based decisions
- ❑ Institutional memory – consistent repeatable processes that go beyond organisational super-stars
- ❑ Stakeholder perspective – extending beyond organisational boundaries to include counterparties; inherited cultures

Forming Risk Committees

- Either optional or mandated by regulation
- Help manage appropriate level of risk-taking.
- Specialised considerations: complex market, credit, liquidity, commodity, regulatory, pricing, reputation, technology, cyber-security, etc.
- Integrated and enterprise wide approach to monitoring and reporting risks

Do firms have risk committees?

E.g. Audit, compensation, strategy, finance committees

Regulating Risk Culture

Risk Culture – 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. [IIF Report 2009]

Indicators of sound risk culture	General supervisory guidance
Tone from the top	Leading by example
	Assessing espoused values
	Ensuring common understanding and awareness of risk
	Learning from past experiences
Accountability	Ownership of risk
	Escalation process
	Clear consequences
Effective communications & challenge	Open to alternate views
	Stature of control function/independence
Incentives	Remuneration & performance
	Succession planning
	Talent development

Source: Financial Stability Board's Risk Culture Guidance

Use of regulation to address failings of culture in firms

- FSB 2014: Guidance on Supervisory Interaction with Financial Institutions on Risk Culture
- PRA 2014: The Use of PRA Powers to Address Serious Failings in the Culture of Firms

Risk Culture of a Firm from a Regulator's View

- Incentives & remuneration structure should reward prudent management
- Board takes responsibility for establishing firm's culture
- Independence of risk management group within firm
- Staff training
- Ability to challenge senior management
- Evidence of a risk governance framework

Institutional Memory

FSB guideline 3.1.12 & 3.1.13 “Learn from past experiences”

- Organisations lacking a way to hold institutional memory
 - Not specific to financial industry

How can the board steer organisation to improve use of its institutional memory

Financial Crime

Financial Crime is any crime involving money.

Financial Services and Markets Act 2000.

- Bank Secrecy Act (BSA)
- Anti-money Laundering (AML)
- Terrorist Financing
- Tax Evasion
- Fraud
- Data Security
- Reporting suspicious activities
- Sanctions violations
- Know-Your-Customer (KYC)

Enforcement through Penalties

Ouch!

Biggest bank settlements with US authorities

Bank	Settlement, \$bn	Date	Cause
1 JPMorgan Chase	13.0	Oct 2013	MBS*
2 Bank of America	11.8	Feb 2012	Foreclosures†
3 Bank of America	11.6	Jan 2013	Mortgage repurchases
4 Bank of America	9.3	Mar 2014	MBS*
5 BNP Paribas	8.9	Jun 2014	Violating sanctions
6 Wells Fargo	5.3	Feb 2012	Foreclosures†
7 JPMorgan Chase	5.3	Feb 2012	Foreclosures†
8 JPMorgan Chase	5.1	Oct 2013	MBS*/mortgage repurchases
9 Bank of America	2.9	Jan 2013	Foreclosures†
10 Credit Suisse	2.6	May 2014	Aiding tax evasion

Sources: Company reports;
national sources; *Financial Times*

*Mortgage-backed securities †Part of \$25bn National Mortgage Settlement
‡Part of \$8.5bn settlement

Source: Economist

Are fears of penalties the best way to get attention at the board level?

Consequences

- Industry undergoing vast de-risking by eliminating from their portfolios
 - business lines,
 - populations,
 - Countries
- Creation of financial exclusions vs democratic goals for inclusion

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