

Risk Culture in Financial Organisations

A RESEARCH REPORT

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Acknowledgements

We are grateful to the following organisations for their generous financial support for this project:

- Economic and Social Research Council (ESRC)
- The Chartered Insurance Institute (CII)
- The Chartered Institute of Management Accountants (CIMA)
- The Lighthill Risk Network

We would particularly like to thank the many individuals and organisations who participated in our study and who were so generous with their time. For reasons of strict confidentiality they are not named. We also thank the Financial Services Knowledge Transfer Network, specifically Dickie Whitaker and Chris Sier for their support, Hollie Seechurn for her research assistance, and Yvonne Guthrie for copyediting. We would like to thank academic colleagues for their input and advice, specifically Wim Van der Stede. Finally we acknowledge our respective institutions, the London School of Economics and Political Science and Plymouth University, for their additional financial contributions to the project.



Introduction

Interest in the cultures of organisations and their effects on management practices goes back many years and there is an extensive body of scholarship on this topic. Yet this interest has increased dramatically in the period since 2008. The debate is led by the world of practice, particularly in the financial services sector. Furthermore, a new twist in the vocabulary of culture has taken place and companies, advisors and regulators now seem to have a specific focus on something called risk culture.

What is this new object that features so prominently in discussion about financial regulation, at many industry events and on numerous blogs? Is it a single thing or does it have many faces? How do companies understand and operationalise it? Do they do this in similar ways? How do financial regulators influence conceptions of risk culture? Is the demand to improve risk culture at all coherent? Can it – whatever it is – be consciously managed? Is it auditable? Is there a single desirable risk culture or are there diverse and plural approaches? If so, are there any limits to this diversity?

In this report we provide some answers to these questions based on our investigations over a period of 18 months. Our research into a constantly developing field is however necessarily incomplete and raises as many questions as it answers. We are also conscious that the debate about culture and risk culture is a very crowded one, with regulators, advisors and trade bodies seeking to provide thought leadership. We therefore offer this report as another contribution to the extensive public debate about the future of financial services.

There have been many efforts to define risk culture and this multiplicity tells us something, namely that it is conceptually rather fuzzy. We decided to go out and listen to the way that different organisations – banks, insurers and their advisors – think about and operationalise risk culture change programmes. We think that this is where the action is – where risk culture becomes, or does not become, an organisational reality. Our report paints a rich picture and we have attempted to provide some intellectual structure to the diversity we have observed. To aid the readability of this report we have shifted a large body of material on methods and other matters to a series of appendices.

In the next section we summarise our findings and provide some prescriptive ideas which different actors in financial services may find useful. The main body of the report begins with an overview of the institutional background to the risk culture debate – which will be familiar to many readers. This is followed by a more detailed account of our approach to the study, including our methods and our own working conceptualization, based on a reading of academic and practitioner studies. We then detail our findings, organised in terms of a number of different themes. Our research positions risk culture as the outcome of a series of trade-offs across a number of dimensions. How our participating organisations approach and think about these trades-offs also suggests an interesting difference between what we call organic and engineered styles of intervening in risk culture. We make no judgement about whether one style is superior to another but we note a paradox: while many individuals will openly support the former, it is the latter which is more visible. We explore the reasons for this.

One of the big unanswered questions in our study is the extent to which individual organisational efforts in the space of risk culture are in fact overshadowed by a trans-organisational regulatory culture with some interesting properties. We make some speculations in this regard but the topic warrants further work.

Finally, we hope that this report will be of interest and use to banks, insurers and other financial organisations; to regulators – both policy makers and supervisors; and to advisors. Rather than make a series of explicit recommendations, we have outlined a number of challenges and questions for senior risk personnel and CEOs, which arise naturally from our research findings.



Executive Summary

It is widely agreed that failures of culture, which permitted excessive and uncontrolled risk-taking and a loss of focus on end clients, were at the heart of the financial crisis. Many official reports, analyses, commentaries and blogs go further to focus on the cultural dimensions of risk-taking and control in financial organisations, arguing that, for all the many formal frameworks and technical modelling expertise of modern financial risk management, risk-taking behaviour and an absence of ethics were poorly understood both by companies and regulators.

From this point of view, we regard the explosion of interest in risk culture in financial organisations since 2008 as being symptomatic of a desire to reconnect risk-taking and related management and governance processes to a new moral narrative of organisational purpose.

The primary aim of our research extending over 18 months and involving several banks and insurers in the United Kingdom, was to discover and analyse how the risk culture change agenda was taking shape inside different organisations. From this grounded and bottom-up point of view we decided not to define risk culture in advance but to observe and understand its manifestations within organisations. We interacted mainly, though not exclusively with personnel from the risk function. Whilst this may be seen as limiting the generalizability of our results, it was clear to us at an early stage that risk culture change programmes were being led by risk functions and that the reshaping of the organisational footprint of risk management was at the centre of these programmes. We supplemented this approach with a formal survey of CII and CIMA members and also engaged, for comparative purposes, with personnel from two non-financial companies – an airline and a large industrial company.

Our desk research of academic and practitioner literature on risk management, management control, culture and safety issues suggested strongly that risk culture is a way of framing issues of risk and culture in organisations and not a separate object. In addition, risk culture is itself a composite of a number of interrelated factors involving many trade-offs. We approached the research with a number of additional prior assumptions:

- Risk culture is not a static thing but a continuous process, or processes, which repeats and renews itself, but may be subject to shocks
- Risk culture will be a mixture of formal and informal processes. The former are easy to observe. The latter are harder to observe since they involve a myriad of small behaviours and habits which in the aggregate constitute the state of risk culture at any one point in time
- We do not assume that an organisation necessarily has a single risk culture and we accept that risk cultures may be trans-organisational. Conceptually we would prefer to speak of 'risk cultures' which may be unevenly distributed within organisations (e.g. in retail as compared with investment banking) or across the financial industry as a whole (e.g. insurers as compared with banks)

Executive Summary

The most fundamental issue at stake in the risk culture debate is an organisation's self-awareness of its balance between risk-taking and control. It is clear that many organisational actors prior to the financial crisis were either unaware of, or indifferent to, the actual trade-off or risk profile of the organisation as a whole. A combination of control functions being ignored or fragmented and of revenue-generating functions being given star status rendered the actual trade-offs involved in this balance institutionally invisible, both internally and externally, until disaster struck.

For this reason, the prescriptions arising from our research essentially point towards recovering the organisational capability to make visible, to understand, and to accept or change the actual control-risk trade-off. Many practitioners now articulate this in terms of organisational clarity about the nature and enforcement of risk appetite and we observe that this plays a large part in many risk culture reform agendas.

Our research reveals that, underlying this fundamental question of balance, our participant organisations were also grappling with several other significant trade-offs as they sought to address risk culture. Unlike a number of consulting frameworks, we do not regard one side of these trade-offs as necessarily 'healthier' than another. Rather they provide a conceptual framework, arising out of our data, which allows us to describe the variety of approaches by our participant organisations.

These trade-offs also provide a way of framing some of the challenges that CROs, CEOs and Boards need to consider.

The swing back to the centralisation of risk management

Our research suggests that the risk culture debate is symptomatic of a desire to make risk and risk management a more prominent feature of organisational decision-making and governance. The pendulum has swung towards an increase in the centralisation of risk management within financial organisations. This is understandable given the events of 2007-9. We observe three interrelated dimensions of this shift.

- Greater structural formalisation of a 'Three Lines of Defence' (TLD) model
- The creation of new risk oversight units and capabilities
- Increased attention to risk information consolidation and aggregation

Underlying this general change in the regulatory and organisational climate are a number of specific trade-offs which define and are fundamental to the way organisations think about and seek to act upon their risk cultures. We have documented the variety of ways in which organisations have consciously and unconsciously addressed these six trade-offs, often mixing approaches. We outline some key challenges for CROs, CEOs and Boards arising from these trade-offs.

Business partner or independent advisor?

The authority of the risk function is a core attribute of risk culture. We observed two approaches to increasing the footprint of risk within organisations. Partnership builders sought to engage directly with the business, seeking to position themselves as trusted advisors. Partnering overseers looked to influence the business via risk training programmes and general awareness-raising activities. The former approach involves acting on the capabilities of the risk function and in developing greater business fluency and credibility. The latter involves acting on the capabilities of the business itself. Both approaches, which are often mixed together, confront 'Three Lines of Defence' (TLD) frameworks which value and promote the independence of the second line risk function. Managing this trade-off between business partnering and structural independence is one among several key challenges.

Executive Summary

Risk culture challenges for CROs, CEOs and Boards

- How would you monitor changes in the internal authority of the risk function? If you don't want to do this, why not?
- Is the current balance between informal relationship building and formal training of the business in risk understood and consciously chosen? Does the risk function have a role in the design and implementation of risk training programmes?
- Are you recruiting and training risk managers in the different languages of the business or is there still an underlying mono-culture within the risk function? In the latter case, have you ever discussed your perception of such culture with colleagues in the risk function?
- Do you generate stories of risk management success and value creation and ensure that they circulate within the organisation and with regulators? Considering the last year, how many of these success stories can you recall?

Informal network building or formal processes?

Regular interaction and 'touch points' between risk functions and the business are widely agreed to be important and not only in financial services. We observed interaction enthusiasts and realists. The former are wary of formal tools on their own, and invest time and resource in building informal internal networks. Realists suggest that too much interaction can inhibit decision-making. They also support the role of technology in mediating interaction - as did our comparator airline. Realists have more respect for TLD models than enthusiasts who continually work across first and second lines. Despite accepting its salience, none of our participant organisations tried to measure risk-business interaction and there seemed to be little ambition to do so.

Risk culture challenges for CROs, CEOs and Boards

- Can you name one or two individuals doing risk culture relevant work in your organisation? If yes, where are they (e.g. risk, audit, business)? How often have you talked to them? Do you feel you give them enough support?
- Would you be interested to know whether and how interaction between your risk function and the business is changing? If so, how could you find this out?
- Do you track how many times business functions approach Risk for advice and partnering? If not, why not?
- If you have implemented a TLD approach in your organisation, do you think this has made interaction between the business and Risk more or less likely?
- Are you worried about a lack of interaction between Risk and the business? If yes, why? Can you think of concrete examples of situations where more interaction would have helped to address business problems? Or examples where too much interaction has slowed decision-making?
- Do you consciously translate risk appetite issues into a language which business units can understand and own?

Executive Summary

Between risk and control?

We observed that the clarity and enforcement of trading limits was regarded as a core feature of risk culture across all our participant organisations. However, we detected subtle differences in approach and attitude to limits. 'Sandbox guardians' (a phrase we heard during our research) position limits as a means to an end and have a business decision facing approach to the enforcement of limits. In contrast, for what we call 'gold-platers' (another term we heard used frequently), limits and related risk management policies and rules unintentionally become a system in their own right. Specific organisational inclinations one way or another were strongly influenced by their own histories and collective memories of bad practice. From the comparator airline it also became apparent that the propensity to invest in knowledge of risk is a risk appetite and risk culture issue.

Risk culture challenges for CROs, CEOs and Boards

- How do you get assurance that the risk function is focused primarily on supporting business decisions?
- Do you know which areas of the business are 'gold-plated' in terms of risk management and control? If not, how will you find this out and what will you do about it?
- When risk limits and tolerances are changed, is the risk function a leader or a follower in this decision?
- Do you understand the appetite for acquiring risk knowledge in your organisation?
- Have you ever discussed internally the implications for risk-taking and/or for your desired level of risk appetite in acquisition strategies, particularly if you plan to buy entire teams from other organisations?

Internal change or the use of advisors?

Under pressure to engage in some kind of risk culture change programme, many organisations have had to make decisions about whether to use advisors or not. We discerned a difference between consulting sceptics and enthusiasts. Sceptics had a mixed set of attitudes: a recognition that change processes must be owned internally to be effective over time, scepticism about formal survey instruments in the market; and a feeling that advisors were primarily selling regulatory compliance. Enthusiasts were also mixed: some were driven by regulation, while others sought leverage to develop new performance management systems with a risk component. Advisors themselves found risk culture a problematic consulting object. They were generally dissatisfied with existing approaches and recognised the need for a mix of skills. They were also searching for new ways to advise on decision-making processes.

Risk culture challenges for CROs, CEOs and Boards

- Does your organisation essentially have respect for advisors? Are you open to advisory propositions? How often have you been contacted by advisors in relation to risk culture in the last three months? How often have you found their proposals novel or of any interest?
- Do you have processes to discuss the kind of expertise you may need, internally and externally, to progress risk culture change? Do you have an appetite for benchmarking with external entities? If yes, what have you done about it?
- Have you ever approached the topic of risk culture in meetings attended by people from both HR and Risk? If you are a member of Risk, do you have access to raw data from internal staff morale surveys or customer satisfaction surveys?
- Is your organisation open to exchanges with research organisations like universities? If not, are you sure of the reasons why? If so, when was the last time there was such an exchange?

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Own risk culture or regulatory culture?

Regulation has undoubtedly been a big driver of risk culture change programmes. Risk culture features in many regulatory speeches. We found that attitudes to regulation were mixed. Frustrated organisations talked about excessive documentary demands, how regulation was interfering with business decisions and how it was crowding out attention to the softer dimensions of risk culture. Co-operatively disposed organisations accepted the new regulatory climate and sought to work with this more actively. A key issue is whether financial organisations understand the extent of the regulatory footprint on their business. The trade-off between their own approach to risk culture and that of the regulator is not even visible to many organisations. It also became apparent to us that there is a regulatory sub-culture in the sense of a network spanning parts of regulators, parts of financial organisations and parts of advisors who share common values. More research into the characteristics of this network is needed.

Risk culture challenges for CROs, CEOs and Boards

- Does your organisation genuinely respect the public objectives of the regulatory function? Do you have positive 'regulation conversations' internally? How often? Who is participating in such conversation (e.g. business, risk, compliance; senior or junior members of staff)?
- Do you push back and challenge the regulator? If not, do you know why not?
- If you think regulatory demands for documentary evidence are excessive, do you have a clear conception of what you would require in the absence of regulation?
- Do you have ways of tracking the extent to which regulation is 'inside' your organisation? Do you have any processes to track the impact of regulation on work habits and internal attitudes to risk? Would you like to know?
- Do you know how compliance experts are regarded in your organisation? If so, do you want to change that? If not, do you want to know?

Levers on behaviour: ethics or incentives?

Behaviour modification is another key issue for risk culture change programmes. We noted two generically different approaches to behavioural risk. The first we call ethics or mission-based. It involves renewed corporate narratives for focusing on clients along with respect for internal control processes. Interestingly, risk management is being re-positioned as a carrier of organisational ethics. In contrast, organisations also invest in disciplinary and incentives-based levers with greater short term purchase over behaviour in the form of risk metrics within the performance management system.

Risk culture challenges for CROs, CEOs and Boards

- Do you understand where in the organisation behavioural change is most necessary? If not, how will you get it?
- Which combination of levers is most likely to be effective in bringing about that change? Is such a combination different in different parts of the organisation (e.g. functional areas or hierarchical levels)?
- How are you monitoring and measuring 'respect' for internal control and risk management?

Executive Summary

Conclusions

Despite the apparent cynicism of the general public, our research demonstrates that financial services firms are engaged in extensive programmes of internal reform with a view to changing their culture of risk-taking and control.

The different trade-offs which emerge from our data are not mutually exclusive. Issues about the authority of risk expertise, the extent of interaction between risk and the business, the clarity of risk appetite, the use of advisors, the commitment to ethical change and whether regulation casts a more significant shadow over risk culture than is commonly acknowledged are all connected. At the same time organisations implicitly choose a balance between longer-term, organic processes of cultural change and shorter-term, more engineered and visible levers over behaviour. Our report also suggests that the TLD model, which has been promoted as a solution to the financial crisis, should be examined at more carefully and critically for its side-effects.

Any research report is limited in time and space, by its methods and by data availability. It is part of the culture of financial organisations that they are not naturally open to external researchers and we have been unusually fortunate with our participant organisations for the access they have afforded us, for their trust in our processes and for their candour in interacting with us for the public good. This is very much their report.

We hope that our study will provide additional awareness of the complex challenges facing CROs, CEOs and Boards who genuinely wish to influence the cultural conditions under which risk-taking and control activity happens in their organisations. Our principal prescription is that there is a need for financial organisations to be aware of the many trade-offs we have identified – including what kind of relationship to have with the regulator - to monitor these trade-offs, and to make explicit decisions about them where possible, rather than allowing them simply to happen to the organisation. When it comes to risk culture, our report suggests that it is not only the level of risk-taking that was deviant in many organisations. It was also the lack of this organisational self-knowledge and the authority to act upon it.

We have documented a number of questions arising from our work as a pathway to achieving this awareness. We have not sought however to position our work as another advisory offering. The fact that the questions we pose are not easy to answer in a familiar practical way does not mean that they are not important. Indeed, we think they require the closest consideration.



Chapter 1:

Background

Risk culture in financial organisations

Interest in the concept of culture has grown significantly since the global financial crisis. The inevitable search for underlying causes and lessons learned has led certain influential commentators to conclude that culture had a key role to play in causing the crisis and that culture change, whatever this might be, is necessary to restore trust and to ensure that a similar crisis can never happen again (e.g. Parliamentary Commission on Banking Standards, 2013b; Walker, 2009; House of Commons Treasury Committee, 2009). As Marcus Agius, chairman of Barclays, stated in October 2010:

"...the leaders of industry must collectively procure a visible and substantive change in the culture of our institutions, so as fundamentally to convince the world once again that they are businesses which can be relied on." (FT.com, 2010a)

This view was reiterated by Stephen Hester, the then CEO of RBS, in 2012:

"Banks must undergo a wholesale change in their culture and refocus their behaviour on meeting the needs of customers to restore trust in the industry." (Reuters, 2012)

Equally it has been observed that culture is not just an industry level problem or one confined to the global financial crisis. Post-mortems on the failures of specific banks and other financial organisations, both following the financial crisis and in the light of more recent events such as payment protection insurance mis-selling, rogue trading and the LIBOR scandal (see Salz, 2013; Parliamentary Commission on Banking Standards, 2013a; Permanent Subcommittee on Investigations, 2013; Ashby, 2011), have highlighted a range of micro-level cultural 'weaknesses' within specific financial organisations. Influential associations such as the Institute of International Finance (IIF) have even gone as far as to state that the:

"...development of a 'risk culture' throughout the firm is perhaps the most fundamental tool for effective risk management." (IIF, 2008)

Despite this widespread interest in the concept of culture, coupled with a growing acceptance of the fact that there is a relationship between the cultures of financial organisations and their risk management decisions, there remain more questions than answers. How does the culture of a financial organisation commonly influence its risk-taking and control decisions? What are the key factors that help to translate a financial organisation's culture into tangible risk management and governance decisions (i.e. is it remuneration, reporting structures, professional ethics or something completely different)? Is it really possible to separately delineate 'risk culture' from culture in general? Can a distinction be made between 'strong' and 'weak' risk cultures and, if so, what can financial organisations practically do to strengthen their risk cultures? And crucially, what can regulators and supervisors do to facilitate this strengthening process, if anything?

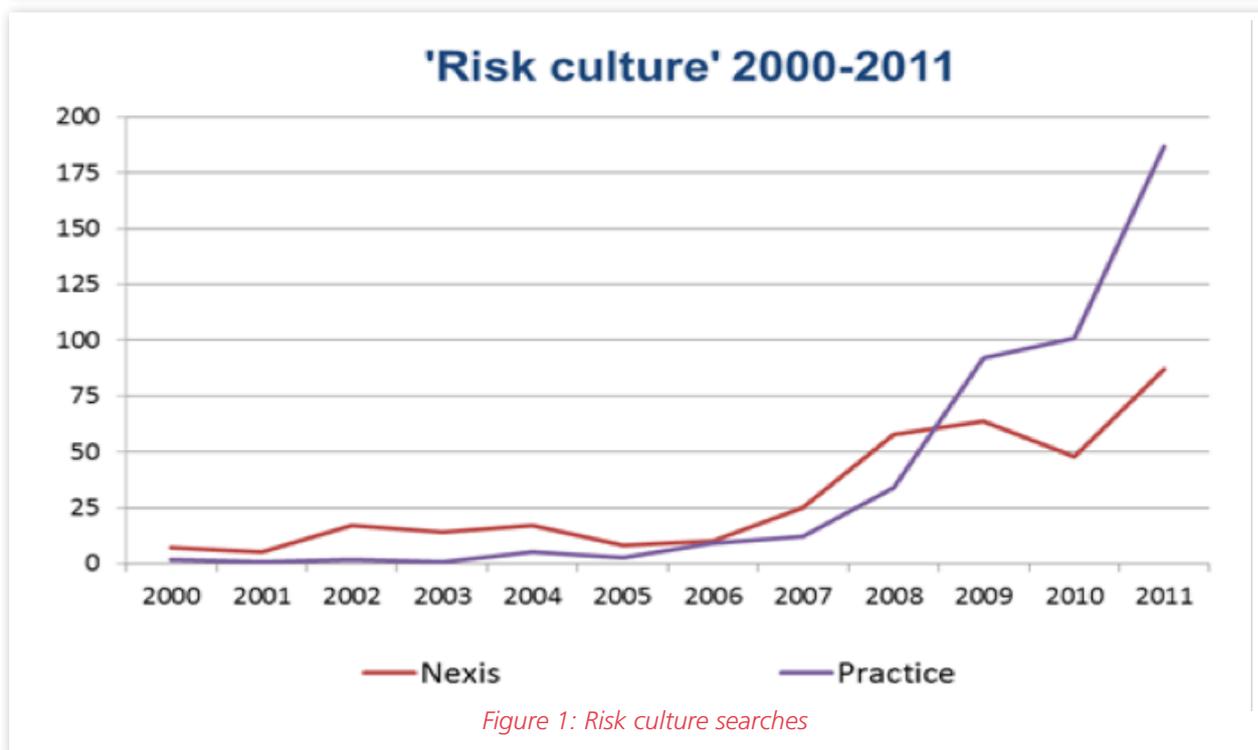
Chapter 1: Background

Therefore, while there is no doubt that culture, and more specifically risk culture, is the dominant aspect of the diagnostic discourses on recent financial crises and scandals (see Box 1 and Figure 1) it is not at all clear what financial organisations or their regulators should do in this space. It is not even clear whether changes in specific elements of risk culture in certain organisations will facilitate more effective risk-taking and control decisions; decisions that should ultimately lead to a better balance between needs of a diverse array of stakeholder groups (such as customers, shareholders, creditors, regulators, etc.) and the achievement of an appropriate level of financial return.

Box 1: Risk culture searches

To obtain a broad overview of the risk culture debate, searches were performed using a news media research tool (Nexis) along with site-specific searches. Specifically searches were performed of the following: 1) UK national and regional newspapers (this included results related to the financial services sector only) 2) an online magazine covering risk issues (Risk Magazine) and 3) The websites of a range of regulatory agencies, professional bodies and consultancy firms. In the case of 3 we not only used Google to help identify relevant sites, but also targeted the sites of key firms/agencies (e.g. the 'Big 4' accounting firms, the FSA, the Financial Stability Board, etc.).

The graph in Figure 1 summarises the 'hits' that we obtained for this phrase from each source (Nexis, and site specific 'Practice' searches). This confirms a significant expansion in the use of the term over the last ten years.



A practical understanding of risk culture

Although many unanswered questions remain, there has nevertheless been considerable activity on the topic of risk culture. For some years now consulting organisations have developed and refined a range of white papers and survey instruments which seek to make risk culture more visible and therefore more manageable.

Chapter 1: Background

More recently professional and industry level institutes have also developed guidance (notably: IRM, 2012; IIF, 2009) and even regulators are beginning to make some tentative policy and supervisory steps in the area (e.g. Adamson, 2013; FSB, 2013a; Group of 30, 2012; PRA, 2013aandb; Basel 2011). We cover all of this work in more detail in our practitioner literature review (see Appendix C).

What is also notable is that, during the life of this project (from May 2012 to July 2013), there were several inquiries into specific financial organisation failures, specifically: the bail-out of HBOS (Parliamentary Commission on Banking Standards, 2013a), the JP Morgan Whale Trading case (Permanent Subcommittee on Investigations, 2013) and the Barclays LIBOR scandal (Salz, 2013).

In each report, detailed analyses were conducted of the underlying causes of these events of the lessons that need to be learned. Risk culture was a key theme in each report although some very different weaknesses in the risk cultures of these organisations are identified, ranging from the presence of deviant sub-cultures in the cases of Barclays and JP Morgan to a strong, but over-confident corporate risk-taking culture in the case of HBOS. However there are also striking similarities in their chosen themes, such as weak federal governance models with marginalised central risk functions, a systemic tolerance of limit breaches and 'brash' and aggressive 'tones from the top'. For example, Salz observed:

"The institutional cleverness, taken with its edginess and a strong desire to win, made Barclays a difficult organisation for stakeholders to engage with. Barclays was sometimes perceived as being within the letter of the law but not within its spirit. There was an over-emphasis on short-term financial performance, reinforced by remuneration systems that tended to reward revenue generation rather than serving the interests of customers and clients. There was also in some parts of the Group a sense that senior management did not want to hear bad news and that employees should be capable of solving problems. This contributed to a reluctance to escalate issues of concern." (Salz, 2013: 7)

Reports into HBOS and JP Morgan reached similar conclusions regarding their cultural dispositions towards aggressive performance objectives and an apparent disregard for risk:

"The strategy set by the Board from the creation of the new Group sowed the seeds of its destruction. HBOS set a strategy for aggressive, asset-led growth across divisions over a sustained period. This involved accepting more risk across all divisions of the Group. Although many of the strengths of the two brands within HBOS largely persisted at branch level, the strategy created a new culture in the higher echelons of the bank. This culture was brash, underpinned by a belief that the growing market share was due to a special set of skills which HBOS possessed and which its competitors lacked." (Parliamentary Commission on Banking Standards, 2013a: 8)

"In contrast to JPMorgan Chase's reputation for best-in-class risk management, the whale trades exposed a bank culture in which risk limit breaches were routinely disregarded, risk metrics were frequently criticised or downplayed, and risk evaluation models were targeted by bank personnel seeking to produce artificially lower capital requirements." (Permanent Subcommittee on Investigations, 2013: 7)

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Interestingly, the same period also saw the publication in the United Kingdom of a damning report into the Mid Staffordshire National Health Trust which observed that:

“Culture has played a significant part in the development of the problems to be seen in this Trust. This culture is characterised by introspection, lack of insight or sufficient self-criticism, rejection of external criticism, reliance on external praise and, above all, fear...from top to bottom of this organisation. Such a culture does not develop overnight but is a symptom of a long-standing lack of positive and effective direction at all levels. This is not something that it is possible to change overnight either, but will require determined and inspirational leadership over a sustained period of time from within the Trust.” (Francis, 2013: 184)

Similarly the January 2011 US Presidential Inquiry into the Deepwater Horizon spill concluded:

“Absent major crises, and given the remarkable financial returns available from deepwater reserves, the business culture succumbed to a false sense of security. The Deepwater Horizon disaster exhibits the costs of a culture of complacency... There are recurring themes of missed warning signals, failure to share information, and a general lack of appreciation for the risks involved. In the view of the Commission, these findings highlight the importance of organisational culture and a consistent commitment to safety by industry, from the highest management levels on down.” (National Commission on the BP Deepwater Horizon Oil Spill and Offshore Drilling, 2011: 9)

So it would seem that (risk) culture is not a ‘problem’ which is unique to financial services. Instead it is increasingly recognised that the culture of any organisation can affect its risk-taking and control decisions in both positive and potentially negative ways. Yet perhaps the cultures of organisations in no other sector have the ability to affect the economic health of nations in such a significant way as that of the financial services institutions.

In summary, problems of culture in organisations have become a prominent form of diagnosis in the period since 2009 and not only in the financial sector (see Atkins et al., 2012). In our view, risk culture is not a separate kind of thing to culture in general. It is rather a specific kind of framing of the culture problem, allowing general concerns about culture to focus on risk-taking and risk control activities. Accordingly, we think the search for a clear distinction between culture and risk culture is pointless. Semantics aside there is no doubt that a risk culture industry has been generated in recent years, fuelled by a mix of advisors, regulators and professional associations all generating thinking and guidance in a new practice space. We include more details of this explosion of practitioner literature in Appendix C. In the next chapter, on our approach to studying risk culture, we draw attention to some of its intellectual foundations.

Chapter 2:

Our Approach

Whilst there is a copious practice literature on risk culture (Chapter 1 and Appendix C), we noticed the lack of explicit academic research on the topic (Bozeman and Kingsley, 1998, Simons, 1999, Power, 2007: 175-8; Ashby et al., 2013 are the notable exceptions). This is not surprising since practice often precedes academic analysis because of lengthy publishing lead times. Nonetheless, there is a substantial body of academic literature that is relevant to our investigations and which has shaped our approach and prior beliefs about the nature of risk culture. We critically review work in the area of 'organisational culture', which, as we explain below, seems to have informed many of the practice outputs (Appendix C). In addition, we review insights from research on safety and organisational incidents, accounting and culture and management control systems. We think that these strands of academic work add significant insights to the analysis of risk culture as a complex organisational phenomenon.

Review of the literature outlined below has shaped our research approach to the study of a relatively unexplored and emerging field of practice. It has also allowed us to build an understanding of specific organisational issues and themes that provide a good point of entry to explore risk culture in financial organisations.

In the following sections we report key insights from our literature review and how they informed our approach to risk culture, data collection and analysis. A complete list of references is provided in Appendix A. We should also re-emphasise at the outset our underlying assumption that culture and risk culture are not two separate and distinct things which must be defined separately. Rather, the interest in risk culture is a way of framing cultural issues from a risk point of view. In other words it is a way of thinking about the cultural dimensions of risk-taking and control.

Organisational culture and risk culture

The topic of organisational culture started to become popular in academic writings from the early 1980s onwards. Barley and colleagues (1988) noted an exponential rate of growth in the total number of papers published annually on organisational culture, from less than twenty in 1979 to about 130 in 1985.

Unsurprisingly, different perspectives and research approaches emphasise different aspects and implications of organisational culture. Culture can be related to leadership, learning and performance, but also to control, ideology and oppression. Table 1 provides key insights on selected definitional work on organisational culture.

Chapter 2: Our Approach

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)

Table 1: *Definitions of organisational culture*

Box 2: *An "anti-management" perspective*

"What is pretended to be a technical, practically oriented knowledge interest is really often an ideological one: the appeal lies in appealing to fantasies of being in the elite, of being grandiose and omnipotent." (Alvesson, 2002: 172)

Contributions on organisational culture can be presented in a continuum where, on the one hand, we have those that take a more objectivist and functionalist perspective, anchoring culture to the concrete experiences of groups of individuals facing internal and external problems (e.g. Schein, 2010, Quinn and Cameron, 2011) while, on the other hand, we have those that take a more subjectivist and non-functional perspective, shifting the focus from actual practices to mindsets and expectations (e.g. Weick and Sutcliffe, 2007). Put in a very schematic manner, the first approach sees culture as 'how we do things around here' while the second

sees culture as 'what we expect around here' (Weick and Sutcliffe, 2007: 115). The former approach puts great emphasis on the capacity for action of organisational leaders and top managers. The well-known work by Schein, for instance, presents 'leadership' and 'culture' as interlinked phenomena. The latter approach is by contrast much more sceptical in relation to the centrality of top managers in driving organisational culture within organisations (see Box 2).

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The design and implementation of new tools to help organisations engineer a ‘good’ organisational culture have become increasingly popular, especially among contributions that embrace an objectivist and functionalist perspective. These tools take the form of technocratic instruments of diagnosis and intervention such as surveys, frameworks and scorecards. A good example of this approach to the analysis and management of organisational culture is the work by Cameron and Quinn (*Diagnosing and Changing Organisational Culture*, 2011). According to the authors, organisational culture is “the most important competitive advantage” that companies have. They assert that “it is difficult to name even a single highly successful company, one that is a recognised leader in its industry, that does not have a distinctive, readily identifiable organisational culture” (p. 5). Many organisational changes do not work because companies do not explicitly address organisational culture as part of the change projects. Hence, their book aims to help individuals and organisations to adopt effective ways of diagnosing and changing culture in order to enhance performance. They propose a comprehensive framework that helps with organising and highlighting the congruence of various aspects of managerial and organisational behaviour. They also work on culture profiling, providing a tool that helps in understanding how an organisation compares with comparable companies and how change in organisational culture may be targeted.

Besides this specific example, frameworks and surveys that are supposed to help organisations to change and manage their culture are particularly popular in the academic (and practice) literature. It is possible to distinguish so-called ‘typing’ surveys, which classify organisations into particular taxonomies, and profile surveys, which are concerned primarily with the description of an organisation’s culture and which categorise organisations in terms of multiple categories of norms, behaviours, and values or beliefs (see, for review, Ashkanasy et al., 2000). These instruments are used with the intent to highlight the congruence of various aspects of managerial and organisational behaviour. They explore differences and similarities between comparable organisations and indicate how risk culture change might be targeted.

Comparing these views on organisational culture and our review of the practice literature (Chapter 1 and Appendix C), we notice how most of the practice literature on risk culture tends to adopt an underlying conception of culture that is objectivist (culture is anchored in systems, structures, and other objective features), functionalist (‘good’ culture promotes the effectiveness and performance of the organisation) and pro-management (‘good’ culture can be changed and engineered by leaders). Understandably, this practice-based literature views culture from a management perspective, describing it as something that an organisation has (just like any asset) and which has a limited number of (usually) measurable and tangible dimensions. From this it seems to follow that there are some ideal elements of an ‘effective’ risk culture, towards which financial organisations should strive (e.g. IIF, 2009).

Indeed, many advisory firms offer risk culture project management services to help ensure improvements – based on gap analyses between an organisation’s current culture and the perceived ideal. We observe in many instances a desire to reduce risk culture to some kind of multi-factor personality profile, which is then used to both analyse the collective risk attitudes and risk management behaviours of an organisation’s decision makers, and also to help change these behaviours for the ‘better’, whatever this might mean. To this end, there are substantial overlaps between the frameworks and tools illustrated in practice outputs and survey-type instruments illustrated in the academic literature on organisational culture (see, for review, Ashkanasy et al., 2000). An indicative example is the recent work on risk culture promoted by the Institute of Risk Management (IRM). A component of the so-called IRM risk culture framework uses the instrument developed by Goffee and Jones (1998) to measure how individual values, beliefs and attitudes towards risk contribute to and are affected by the wider overall culture of an organisation.

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Box 3: *Hierarchists vs. fatalists*

Hierarchists will focus on establishing risk systems that define risk appetite and clear risk-reward relationship. On the contrary, fatalists will have little faith in such initiatives as any risk system simply impedes them from reacting as circumstances change (IRM 2012)

In general, the practice literature on risk culture draws heavily on comprehensive frameworks, diagnostic tools and profiling instruments. This emphasis on profiling organisations or groups of individuals also made the so-called Cultural Theory of Risk, developed by Douglas and Wildavsky (1982), an appealing reference point within the practice-based literature. Although this work has different conceptual foundations from organisational culture survey instruments, it shares an ambition to categorise different types of cultures. The Cultural Theory of Risk identifies four possible types of culture

– hierarchical, individualistic, egalitarian and fatalistic – suggesting that each cultural type pays attention to risks in different ways. The message that is often picked up in practice outputs is that it is important for companies to recognise the presence of these four cultural types in order to explain the disagreements that may arise as adherents of the different cultures defend their perspective. Box 3 provides an excerpt from the IRM report on risk culture, which illustrates the application of cultural theory.

The ambivalence of risk culture(s)

It is clear that if risk culture is to be ‘managed’ in any ordinary sense of that term, then it must necessarily be reduced and simplified to some observable properties that can be acted upon and audited by others, such as regulators (Power, 2007). However, this reductivist approach to risk culture is also rather narrow. Both culture and risk are complex multi-dimensional concepts, so while certain organisations may fit the narrow risk culture profiles that have been identified, many others will not. This issue is likely to be especially acute in the financial services sector, where there is a wide variety of organisations (large-small, domestic-international, proprietary-mutual, etc.) working in a range of markets (retail, commercial, investment, insurance, etc.).

Moreover, equating *managing* culture with *changing* culture may underestimate organisational complexity (see Alvesson, 2002). First, change can have negative cultural consequences (for instance, consider organisational change initiatives stressing downsizing and delayering); second, explicit cultural change initiatives are likely to arise while other continuous changes are taking place (e.g. new persons replacing others, people getting older and retiring) which are culturally relevant. Hence, a carefully planned project management approach to cultural change may not work since it addresses a moving target.

Specifically, we are somewhat sceptical of the strong practical focus on ‘new’ tools to measure and manage risk culture even though we understand why this approach is adopted. First, the tool-making space seems to be highly populated and therefore we assume organisations can already find tools that suit their needs rather than adopt a new kind of management product. Indeed, many risk culture products are adaptations of existing tools and techniques. Second, prior work (Power, 2007, drawing inter alia on Weick, 1993) suggests that risk culture tools (e.g. surveys, measures, frameworks) inevitably reduce complexity up to a point where risk culture measures become the primary focus of managerial and regulatory attention, rather than being used as proxies and stimuli for organisational conversations.

This complex relationship between objects of measurement and measurement tools is explored in a range of studies in the accounting literature (e.g. Dent, 1991; Ahrens, 1997; Bhimani, 2003). This work shows how

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management accounting and performance measurement tools are not mere objective representations of an external reality, but that they actively contribute to changes in the organisational contexts in which they operate. So, new measurement tools do not just measure; they are the vehicle for new cultural values such as ‘profit-oriented’, ‘flexible’, ‘customer-oriented organisations’, etc.

For example, the study by Dent (1991) shows how the idea of a ‘business railway’ became progressively concrete within an organisation operating in the transport sector in the UK. This happened through a combination of coincidental and gradual organisational changes, including the appointment of ‘business managers’ outside the main line-management hierarchy of the railway (see Box 4). The business managers started with a vague concept of a ‘business railway’, but over time they gradually secured increasing contexts for interaction, leveraging formal accounting systems and procedures that gave them the rights to participate in and influence decisions. The key point is that accounting systems embody particular assumptions about rationality, organisation, authority and expertise, and their use contributes to cultural changes in organisational knowledge and meanings.

Box 4: *Cultural acclimatisation*

“We introduced it in an evolutionary way. We said: ‘Let’s appoint Business Managers and then let it evolve. Be patient and let it evolve.’” (Quote of a Chief Executive in Dent, 1991: 716)

In the context of our research approach, academic contributions such as these have two implications. First, they emphasise the episodic and coincidental nature of cultural change, a concept of organisational change that differs strikingly from the grand technocratic projects (drawing on the terminology used by Alvesson, 2002, Ch. 8) described in some academic and practice work on organisational culture (e.g. Cameron and Quinn, 2011). Second, they suggest that decisions on the types of tools and approaches embraced to measure, manage and account for risk culture may not themselves be risk culture-neutral. Choosing both whether and how to measure is itself a culturally significant decision which will shape how organisational actors think about and act upon their (perceived) risk cultures. Hence our starting position is that risk culture tools cannot be seen as detached from, or outside, the risk culture they promise to measure. They will instead contribute to shape risk culture as part of a wider organisational reality made of multiple and changing processes, actors and episodic events. In short, the adoption and use of risk culture tools can be revealing of risk culture(s), although not in the functionalist and objectivist sense envisaged by some academic contributions and by most of the practice outputs.

From this point of view, our approach differs from most of the prior contributions on risk culture. Like Alvesson (2002), we believe that academic work on (risk) culture can be significant not in the form of providing ‘new’ tools to enhance organisational performance, but as a way of exploring organisational life in all its richness and variations. Rather than providing yet another formula or tool to assess what a good (risk) culture is and prescriptive rules to engineer it, our approach begins by examining how organisations think about risk culture, the reasons that led them to an increased preoccupation with risk culture, and the concrete work streams and change programmes that they put in place to make risk culture a visible and manageable issue in the organisation.

Consistent with the work of prominent organisation studies scholars (e.g. Weick, 1979; Alvesson, 2002), we approach (risk) culture by facing its ambivalence head on. Specifically, we frame this ambivalence in terms of how organisations deal with a number of trade-offs and tensions related to multiple and changing cultural manifestations, and the organising efforts that happen around them. As noted by Weick (1979), almost any system needs to incorporate ambivalence in order to remain both adaptable (flexibility) and to maintain its

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Box 5: *Ambivalence and banking*

“‘To make money you have to lend it rather than store it.’ Having realised this, the bank then acts as if that knowledge is both true and false. It acts as if the statement is true by continuing to select from enacted inputs those occasions where there is an opportunity to lend at a profit. It acts as if the statement is false by urging customers to be thrifty and use the bank as a repository for the results of that thrift. It is good to save and bad to borrow, it’s good to borrow and bad to save. That complicated definition is something that a bank must manage as a continuous routine matter.” (Weick, 1979: 222)

current adaptation (stability) (see Box 5). For example, as Alvesson (2002) suggests, organisational culture can provide a sense of meaning and direction, but, in so doing, it reduces autonomy and discretion. In other words, culture is useful for making complex interaction and coordination possible, but it is, at the same time, constraining and repressive. This is one of the many ambivalent manifestations and contradictions of culture and cultural change initiatives. A concrete example relates to the use of notions of decentralisation in organisational change initiatives. Alvesson (2002: 183-184) notes that when senior managers give a speech before organisational redesign, they often invoke values such as ‘decentralisation’ and ‘participation’. But, in giving speeches such as these, they paradoxically reinforce their hierarchical position and dominance over the organisation’s fate.

Risk culture as multiple trade-offs

The necessity of trade-offs in organising around (risk) culture is reinforced by issues raised in a number of different bodies of literature on safety, organisational incidents and crises, and management accounting and control.

Beginning with the safety literature, a foundational text on the management of the risks of organisational accidents (Reason, 1997) outlines the key tension between ‘production’ and ‘protection’. The argument is that the operations of almost any organisation are bounded by two dangerous extremes. Where protection exceeds the dangers posed by productive hazards, an organisation risks going out of business because protection consumes too many resources, i.e. people, money and materials. Later in this report, we refer to a similar notion – that of ‘gold-plating’ control. On the contrary, where protection falls short of the required productive safety, an organisation faces the risk of suffering a catastrophic accident (and again going out of business). Therefore the survival of an organisation depends on the balance between production and protection concerns. However, this balance is likely to be constantly subject to changing local circumstances and pressures, such as prior incidents and the fluctuating availability of financial resources (see Box 6).

A practical example of a trade-off that characterises decisions around safety-related arrangements can be found in an analysis of the BP Texas Refinery disaster (Hopkins, 2009). The author suggests that decentralisation, which in most cases is seen as a ‘good’ thing, as it allows decisions to be taken at the site or local business level, in fact undermined process safety. The argument is that decentralisation makes it difficult to hold individual business units accountable for process safety performance, since major accidents are rare events. As individual sites rarely experience a major accident, managers naturally become complacent with respect to the management of major hazards.

Box 6: *Production vs. protection in practice*

“Almost every day, line managers and supervisors have to choose whether or not to cut safety corners in order to meet deadlines or other operational demands. For the most part, such short cuts bring no bad effects and so can become an habitual part of routine work practices. Unfortunately, this gradual reduction in the system’s safety margins renders it increasingly vulnerable to particular combinations of accident-causing factors.” (Reason, 1997: 5)

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Moving to work on organising under conditions of crisis, the work of Weick and colleagues (Weick, 1990, 1993; Weick and Roberts, 1993) emphasises the ‘necessity for talk’, continuous interaction and abandoning hierarchy during a crisis. From this point of view, risk management can be seen as an on-going organisational conversation sustained among key actors. More interaction, open communication and ‘speaking up’ are seen as a good thing that should be encouraged. So in relation to the need for interaction it would seem that there is less disagreement between the non-functionalist academic literature and practitioner work on risk culture, which is also in favour of more communication, raising red flags, openness to ‘bad news’, etc. However, Weick and colleagues importantly qualify the value of interaction. They develop concepts of ‘heedful interrelating’, ‘collective mind’, and ‘respectful interaction’ to characterise the type of interaction that can be beneficial. This is in fact opposed to a more simple view of ‘let’s just talk more’ (see Box 7). Therefore, it is not only the level of interaction about risk but also the type of interaction, how and when it happens that matters to risk culture.

The emphasis on the right kind of interaction about risk can be seen in partial contrast to the emphasis on a consistent ‘tone from the top’ or the ‘heroic’ risk champion (e.g. a CEO changing the culture) that is often idealised in the practice literature on risk culture. A culture that encourages individualism, survival of the fittest and ‘can do’ reactions will often neglect attentive practices of representation and interaction (Weick and Roberts, 1993) – an observation which seems to have prima facie relevance for the financial services industry. Finally, risk management as a sustained and on-going conversation also poses challenges of documentation, accountability and auditability, which became in the last decade prominent issues within the regulatory and managerial spheres (Power, 2007). So even where interaction is regarded as an important dimension of risk culture, there are trade-offs between the right kind of attention and ‘mere talk from the top’, and between interaction as continuous and on-going, and the regulatory need for documentary traces.

Box 7: *Respectful interactions*

Three imperatives for social life (Weick, 1993: 640-643):

- Respect the reports of others and be willing to base beliefs and actions on them (trust)
- Report honestly so that others may use your observations in coming to valid beliefs (honesty)
- Respect your own perceptions and beliefs and seek to integrate them with the reports of others without deprecating them or yourselves (self-respect)

Box 8: *How do risk experts gain influence?*

Four types of risk experts (Mikes et al., 2013):

- Compliance champions play an important regulatory role
- Business partners “gain the ear of decision makers” through continuous personal involvement
- Technical champions make their tools easily understandable (e.g. consultant-like approach)
- Engaged toolmakers develop new tools that embody their expertise

The authority and expertise of risk personnel is another theme that presents relevant trade-offs and tensions. A growing body of the literature has explored the role of the risk managers in financial and non-financial organisations (e.g. Power, 2007; Mikes, 2011; Mikes et al., 2013). This body of work suggests a shift in the role of the risk manager, from the ‘technical expert’ of one or many sub-disciplines of risk management to the ‘business partner’ and ‘change facilitator’. Recent work (Mikes et al., 2013) shows that risk personnel can get the attention of top management in different ways, ranging from continuous personal interaction to the development and dissemination of new tools (see Box 8). The key point for our trade-off approach is that these choices are far from being uncontested. Whilst some may praise closer contacts

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Box 9: How risky is your company?

Simons' Risk Exposure Calculator (1999) is composed of 12 keys that reflect different sources of pressure for a company. Managers should score each key from 1 (low) to 5 (high).

'Alarm bells' should be ringing if the total score is higher than thirty-five. The keys are: pressures for performance, rate of expansion, staff inexperience, rewards for entrepreneurial risk-taking, executive resistance to bad news, level of internal competition, transaction complexity and velocity, gaps in diagnostic performance measures, degree of decentralised decision-making.

between risk functions and front-line business, others (regulators in particular) may be more sceptical, stating that risk people should maintain their independence.

Finally, the relevance of trade-offs is also evident in the literature on management accounting and control systems. Simons (1995) addressed the problem of how managers can exercise adequate control in organisations that demand flexibility, creativity and innovation. The problem is that employee initiatives that exploit opportunities and address customer demands should be welcome. But, at the same time, the pursuit of some opportunities can create excessive risk exposures and lead to corporate failure. To manage this tension, Simons suggests that managers can draw on four 'levers of control'. Traditional diagnostic controls, which emphasise the alignment of results to expected targets, can be complemented by: interactive controls that open

organisational dialogue to encourage learning, belief systems that communicate core values and mission of the organisation and boundary systems that specify and reinforce rules to be followed and risks to be avoided. Simons (1999) expanded his work on the levers of control by introducing the so-called 'Risk Exposure Calculator' (see Box 9). This tool suggests that 'risk culture' may be analysed in terms of three key variables: the balance between entrepreneurial risk-taking and demands for control, how organisations deal with executive resistance to 'bad news' and the degree of internal competition and performance pressure. In relation to the trade-off idea, it is significant that high and low scores can be seen as equally problematic. As put by Simons (1999: 87), "innovative, successful companies invariably create risk pressure. If your business scores in the safety zone, perhaps it's time to take some calculated gambles."

To summarise, borrowing from insights and findings of different literatures (safety, accounting, risk management, organisational crises), our approach to the investigation of risk culture is primarily oriented towards the different trade-offs, tensions and contradictions which are at stake in making it operational. Figure 2 suggests that what may be seen as indicative of a good 'risk culture' (e.g. more protection and controls, more and closer interaction) may have a number of unintended consequences. A key issue for financial organisations to be explored in this report is the extent to which they are aware of these different trade-offs and therefore explicitly decide to be where they are or whether the trade-off is arrived at implicitly and unintentionally.

Production vs Protection	Limit the dangers posed by productive hazards. Increasing protective measures is 'good'...	Yes, but can too much protection consume too many resources?
Interaction	Risk management as on going organisational conversation: More interaction is 'good'...	Yes, but how does more interaction relate to 'can do' cultures? Which has implications for documentation and accountability?
Risk Expertise	Risk managers as business partners: Closer relation to the front line is 'good'...	Yes, but what about independence, authority and expertise?
Entrepreneurial Risk-Taking	Avoid reckless risk taking: More control on individuals' risk taking is 'good'...	Yes, but what about innovation, creativity and entrepreneurship?

Figure 2: Trade-offs

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Thinking risk culture(s): our approach

In the previous sections we argued that we find current approaches to the study of risk culture narrow because of their focus on the measurement of risk culture, the profiling of a limited set of organisational variables and the prescription of a set of rules for 'good' risk culture. We also drew on several different academic literatures to reveal the significance of the numerous trade-offs related to organising efforts around risk culture. Building on this analysis, we can summarise our approach and focus in the following way. Our approach to the study of (risk) culture can be defined as functionalist-neutral (we have no ambition to define 'good' or 'bad' risk culture although our report is prescriptive in a number of other respects) and 'bottom-up' (we focus on how financial organisations think about risk culture and organise change processes). At the heart of this bottom-up investigation is the attempt to reveal the tensions and trade-offs related to different ways of organising around risk culture. Our assumptions about risk culture are minimal and modest (see Box 10) and reflect ideas of 'plurality' (risk cultures as opposed to risk culture) and 'drifting' (change is continual in organisations and may be more or less loosely connected to specific risk culture change programmes).

Box 10: *Our assumptions about risk culture*

- Risk culture is not a static thing but a continuous process, or processes, which repeat and renew themselves but may be subject to shocks.
- Risk culture will be a mixture of formal and informal processes. The former are easy to observe; the latter are harder to observe since they involve a myriad of small behaviours and habits which in aggregate constitute the state of risk culture at any one point in time.
- We do not assume either that an organisation has a single risk culture or that a risk culture may not be trans-organisational. Conceptually we would prefer to speak of 'risk cultures' which may be unevenly distributed within organisations (e.g. retail as compared with investment banking) or the financial industry as a whole (e.g. insurers as compared with banks).

There is a fundamental trade-off at stake in risk culture between risk control and risk-taking activities. This overarching trade-off is the basis of our simple visual conceptual model of risk culture in Figure 3. In a similar way to the tension between production and protection (as highlighted in the safety literature, see Reason, 1997) and the tension between entrepreneurial risk-taking and control (from the management control literature, see Simons, 1995, 1999), the basic idea of our conceptualization is that both too much control and too little control can lead to mediocrity or lost opportunity (risk of bankruptcy) and catastrophe or value destruction (risk of catastrophe) respectively. This is a bandwidth model of risk culture, meaning the operational space between organisationally specified levels of control and risk-taking. Reckless organisations are not necessarily high risk-taking organisations as such. They are rather those which violate their authorised bandwidth limits. In a similar vein, precautionary organisations may in fact operate beyond their authorised control propensity (i.e. the level of control - 'gold-plating' - may hinder the achievement of business objectives). While the risk culture debate is primarily motivated by the spectre of reckless risk-taking, the bandwidth model is more neutral and symmetrical. It applies equally to the organisational violation of risk-taking and control boundaries.

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Figure 3 is not intended as a prescriptive model of good risk culture in the sense of a specific balance between risk-taking and control, but it is prescriptive in another sense. The model suggests that a good risk culture essentially involves clarity about the organisation's target bandwidth or what might be called the desired net risk position. In the example in Figure 3, in both organisation A and organisation B there is a gap between the aspired and actual position in terms of risk control / risk-taking. Figure 3 is a simplification but it suggests that what happens at both the aggregate organisational level and in specific settings matters. It also tries to recognise that in some organisations there may be greater homogeneity between different organisational units (e.g. organisation A in Figure 3) than in others (e.g. organisation B). Specific areas and hot spots may drive a business outside its prescribed 'safe' zone (e.g. unit B is leading organisation B beyond its target bandwidth). It follows from Figure 3 that risk culture is partly a problem of clarity about, and commitment to the enforcement of bandwidth limits, which may be defined in risk appetite or tolerance policies.

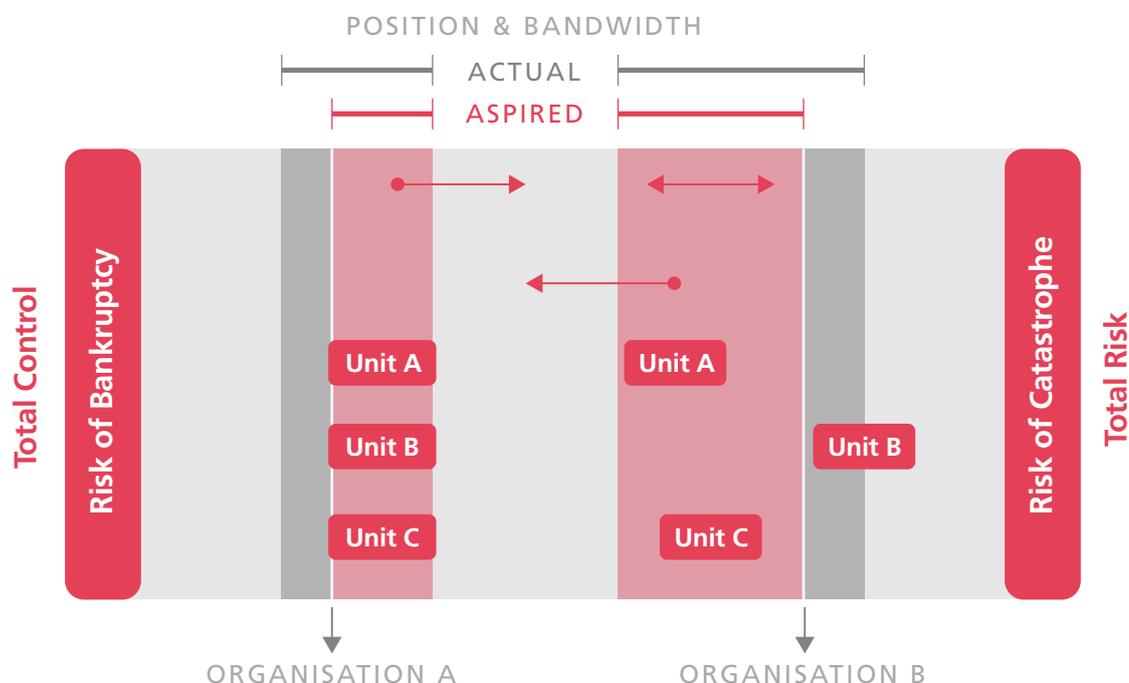


Figure 3: Risk culture as 'risk and control trade-offs'

Figure 3 also suggests it may be more useful for organisations to focus on the specific 'stress points' in risk cultures which might lead to a violation of bandwidth boundaries (e.g. hiring and promotion, performance planning and rewards, relations with regulators, new product development), rather than imagine that risk cultures matter equally in all parts of the organisation.

From our desk research, literature reviews and preliminary findings (see our interim report, Ashby, Palermo and Power, 2012) we looked for further specific areas of investigation as good 'bottom-up' entry points to uncover the variety of cultural manifestations of risk culture around risk-taking and its control. The areas which emerged were: risk culture organisational change initiatives, risk personnel authority and expertise, internal touch points between risk functions and the business, interactions with external actors (e.g. consultants, regulators), and different investments in levers over behaviour. Table 2 summarises the intellectual origins of the five areas of investigation, outlining how they are potentially productive of insights about the trade-offs involved in organising around risk culture.

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Table 2: Areas of investigation

	Key insights, trade-offs and tensions	Key Questions	Literature (References)
Risk culture change initiatives	Risk culture is often seen as part of organisational change initiatives. But organisational changes to modify culture can have unintended effects (e.g. decentralisation and process safety). Moreover, cultural change processes can be gradual, fortuitous and accidental rather than the rational deployment of a 'grand technocratic project'	What reasons lead organisations to an increased preoccupation with risk culture? What are the concrete work streams put in place to manage risk culture? Do these work streams emphasise technocratic change projects or organic change processes?	Safety culture (Reason, 1997; Hopkins, 2010) Organisational culture (e.g. Alvesson, 2002) Accounting and culture (Dent, 1991)
Risk personnel authority and expertise	Risk managers and chief risk officers can be seen as promoters of risk culture change initiatives. However, their authority and expertise is far from consolidated and uncontested.	What are the roles and ambitions of risk personnel in relation to risk culture? What type of expertise do risk managers use to work on risk culture?	Risk management and accounting (Power, 2007; Mikes, 2009, 2011; Mikes et al., 2013)
Internal touch points	Interaction is seen as an important feature of risk and crisis management. Open communication and interaction can be seen as dimensions of 'good' risk culture. Yet the literature on organisational crisis suggests that what matters is the respect built through interaction between individuals. Moreover, continuous interaction may have dysfunctional consequences in terms of information overload and lack of accountability.	What does the level of internal interaction tell us about respect, authority and cooperation between front-line and staff functions (including risk)? How does interaction change with respect to internal and external shocks? How is information escalated and information overload managed?	Management studies of organisational crises and accidents (Weick, 1990, 1993) Management accounting and levers of control (Simons, 1995, 1999)
External interactions	Risk culture work can hardly be seen as separate from the distribution and changes in fashionable ideas driven by mass media, higher education, management books and consultants. Notably, whilst internal risk cultures will tend to expand organisational complexity, tools supplied by external agents may reduce complexity so that risk culture becomes a visible object of managerial and regulatory attention.	What types of tools are used by practitioners? Are they purchased externally or built in-house? How do consultants and regulators deal with issues of risk culture visibility and manageability?	Risk management, accountability, auditing (Power, 2007) Organisational culture (Alvesson, 2002)
Triggers of behavioural change and pressure points	The literature on management control and organisational culture has described different levers to act on risk culture. Much of the recent discussion in the practice and regulatory literature is centred on diagnostic controls, rewards and sanctions. But the notion of organisational culture emphasises the relevance of values, norms and ethics.	What are the pressure points in risk cultures? How do they affect risk cultures? What are the levers used by organisations to trigger behavioural change? What does trigger behavioural change?	Organisational culture (Schein, 2010; Cameron and Quinn, 2011) Levers of control and pressure points (Simons, 1995, 1999)

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Methods

Our methods are elaborated further in Appendix B. We decided at an early stage that our point of entry into risk culture was via corporate risk functions, working jointly with CROs and other relevant actors. We accept that this starting point is a limitation of our approach but we took the view partly on pragmatic grounds – these were the easier points of entry to organisations – and partly from a prior view that the risk function was most likely at the centre of risk culture change programmes and reflective of them. In line with our bottom-up approach, we interviewed relevant actors in sixteen organisations, including consultants and often involving follow-ups. The interviews were unstructured other than being informed by the five themes in Table 2 above. The organisations in our small sample range from large providers of various types of financial services (e.g. insurance, investment and retail banking) operating on a global scale, to much smaller organisations operating locally in the UK. A total of more than sixty individuals have been met, of which most hold a senior position in the risk management area of the organisation (e.g. CRO or deputy CRO) (see Table 5 in Appendix B).

As a follow-up to the interview process we customised a short survey instrument to capture different aspects of risk-taking and risk control activities, which was administered in three organisations (two insurers and one bank). We then discussed the survey results with key staff in each of the three organisations within focus group settings with different organisational representatives present. These focus groups involved senior managers in a range of positions, including CEOs, CROs, Heads of Business Units, Internal Auditors and Compliance Officers.

An extended version of our questionnaire was also developed and administered within the membership of the Chartered Insurance Institute (CII) and the Chartered Institute of Management Accountants (CIMA). These surveys enabled us to obtain extensive data from across a significant sample of individuals working in the financial services sector. However, because of limitations of space we have not reported extensively on the results of these surveys in this report but they have been used to inform the analysis of some of findings from the interviews and focus groups.

Overall, our research approach has adopted mixed methods, being primarily informed by desk research of pertinent publicly available documents (see Appendix C), and interviews with relevant actors within financial organisations, consultancy firms and regulatory bodies. Any research approach like this is necessarily imperfect and limited by the constraints of access, time and resources. Indeed, it is part of the culture of financial services that it is typically difficult to access for external researchers – although insurers and banks differ somewhat in this respect. Nevertheless, despite these limitations, we think our findings as detailed in the remainder of this report will be of interest and add to the richness of the current debate.

Chapter 3:

Findings Overview

As noted above, our approach combines insights from existing work on organisational culture with a bottom up approach to investigating the work streams that organisations have been undertaking in order to understand and enhance the cultural strength of their risk management activities. There has been unrelenting general pressure on financial organisations to pay more attention to their risk cultures – especially with the publication of a sequence of influential reports in 2012 and 2013 (as discussed in Chapter 1) – and the main body of our report documents some of the considerable variety of approaches visible in the work of our participant organisations. However, one theme seems common to, and underlies, all these change programmes – increased centralisation both of the risk function and of management control more generally. In the next section, we outline our findings with respect to this theme of increased centralisation. We then introduce the various trade-offs which will be explored in more depth in subsequent chapters.

Risk culture: the swing to centralisation

It might be reasonable to expect that an analysis of risk culture would begin by looking at ethics or incentives. And yet structural changes, including the increasing prominence of the ‘Three Lines of Defence’ model were a significant aspect of our conversations about risk culture in financial organisations. Structures change over time and organisations go through cycles of centralising control and authority and then decentralising it again. As our background section above suggests, many of the problems experienced at financial organisations (e.g. Barclays, HBOS and UBS) could be traced in part to a fragmented risk management function with little capability of taking an aggregate view or exercising central organisational oversight. So it is not surprising that a reaction to these issues, both by organisations and their regulators, has been to strengthen central risk oversight and to have organisation-wide standards of risk management and control centrally enforced. Indeed, when it comes to risk culture the first moves seem to be structural in nature.

However, centralisation has different faces and we observe that financial organisations have pursued this structural change agenda in three interrelated ways:

1. by paying more attention to, and reproducing the so-called ‘Three Lines of Defence’
2. by creating new ‘risk oversight’ functions
3. by redesigning risk information and related flows

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The Three Lines of Defence (TLD)

As one interviewee put it, the mistake of the regulator in the past was to focus too much on 'risk management' and not enough on 'risk oversight'. Since 2009, there has been much more focus on defining and operationalising 'risk oversight' both as a responsibility of the Board and of central risk management functions. This view implies that risk management is primarily the job of the business lines themselves – the so-called 'first line of defence'. Every other control function, such as audit and the risk management group itself, has a relationship of 'oversight' to the first line. This is the essence of what has come to be called the Three Lines of Defence model (TLD), although the board, external auditor and regulator might well be fourth, fifth and sixth lines of defence. The first line is the business itself with its own supervisory capacity to manage risks. The second line is broadly the central risk management function in a policy setting and advisory role, and the third line is the internal audit.

Although TLD has become something of an orthodoxy, especially amongst regulators and consultants, we met few practitioners who thought about it in its pure form. This suggests that the model is not fully descriptive of organisational realities. It was clear to us that, while it provided some kind of ideal reference point or benchmark, it often did not fit the kinds of structure that many organisations wished to use. For example, one insurer identified a tension between the first and second lines – the business and risk management – where information demands by the latter are sometimes perceived as excessive and non-value adding by the former. From this point of view it is better to load more risk management into the first line and reduce the oversight burden. At another insurer, the TLD was in an early stage of development in 2012 and the position of a Group CRO had only just been created. This CRO aimed to develop divisional CROs who would be firmly embedded in the front-line management team but who would maintain independence by virtue of strong 'dotted-line' reporting to the central CRO. Similarly, another insurer wanted to place risk 'players' within businesses perceived as having looser controls, for instance acquisitions in which controls were more decentralised. At a regional building society, we also found challenges to TLD model and a richer conception of the role of the risk management function. The interviewee questioned herself: "So what am I? Am I the policeman, am I the friend, am I a critique?"

An advisor to an Australian based bank noted the potential for conflict between first line and second / third line control functions. This potential was especially relevant in periods of change, where there may be a misalignment between the expectations of these two groups. At the time of our discussion we learned that "lever of control functions" were being used to drive the shift towards a lower level of risk appetite. However not everyone in the front-line was ready for this change. This led to tensions while the two lines of defence went through a process of alignment.

It was also acknowledged that a degree of tension between the first and second lines is healthy, if the second line is exercising an appropriate amount of challenge (something widely considered to be important to risk culture). But this challenge process involves a delicate balancing act. Too aggressive an approach can alienate the risk function from the business units; too much friendliness and they can become captured and end up 'in bed with the business'. Another common pressure point between the first and second lines is, as we suspected, new product development. The group risk function at this bank has the power to block the development of new products, which creates tension with the front-line - who clearly do not appreciate having their ideas blocked. The problem here is that assessments of risk and return for new products are inherently subjective and open to cognitive bias - the risk function being more pessimistic about risk and return, relative to the front-line. These tensions suggest that risk culture is not only a question of structures and TLD. It also depends crucially on key individuals with the capabilities to operate credibly at the first / second line interface in hybrid ways. But this may not always be attractive to regulators who prefer a much more black and white distinction between these two lines.

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To summarise: TLD has become a norm by which the quality of risk management and risk oversight is being evaluated and judged. This despite the fact that this norm is not based on any clear evidence. In the case of HBOS there is even evidence to the contrary. According to the Parliamentary Commission on Banking Standards (2013a), the presence of a centralised risk management function and apparently strong risk governance did nothing to prevent disaster. Furthermore, role tensions and ambiguities at the interface between the first and second line seem to be inherent in all the risk culture change programmes we encountered. While the distinction between first and second lines of defence was highly institutionalised in regulator and advisor thinking, it seemed to be unhelpful in addressing some of these more fuzzy issues. Rather than forcing key organisations into a standardised binary system like this, the policy issue may be to have greater awareness that this interface is a key space in which risk culture is enacted and that potential conflicts of interest and risks of capture should be managed with awareness, rather than blended out in the name of an ideal. This seems more in line with the operating reality of organisations, particularly those with large group structures, where unitary systems and processes can be inflexible and hard to enforce. We shall return to the TLD at several junctures in the analysis in later chapters but the discussion so far suggests that organisations face a decision about how to balance the purity of the TLD model which preserves the structural and perceived independence of the risk function, and the pragmatic modification of this model to embed some risk capability in the business units.

Risk oversight

A number of advisory organisations have promoted the creation of new risk oversight functions. Although these new central units were in their early days of operation and the process was not without frictions, they were seen by their proponents as very important for enhancing risk culture. BANK_2 experimented by creating an entirely new risk oversight function reporting directly to the board in the UK and headed up by a new, additional CRO with a greater degree of separation from the local CEO. In the UK the changes involved a long process of discussion with the regulator (the FSA) to position this new CRO as a pure risk oversight function. While the bank saw this restructuring as positively rebalancing the cult of the CEO which had been problematic at other banks, the idea of two CROs was harder to sell to the regulator. In many respects the new oversight structure was a kind of risk supervisory board. The new senior CRO now reports directly to the main (Group-level) board with the support of a small oversight team of experienced risk people, with diverse skills and knowledge, including in front-line business operations. The example suggests that structural changes and changes in expertise often go hand in hand. Indeed, structural changes may only work when they are supported by the right capabilities (see Chapter 4).

This specific initiative is of interest because its structural and role innovations cut across the TLD model and created tensions with the regulator. It also illustrates one particular path of centralisation – the creation of a new kind of oversight unit – which a number of other organisations have taken. Elsewhere, centralisation involved enhancing existing risk management functions. At the subsidiary of a global bank, we heard that a recent increase in risk management centralisation and control by the global head office (especially in relation to operational risk) had taken place. Similarly, at the UK subsidiary of a major insurer, which had enjoyed more independence in the past, there was also an increase in group level control from overseas. Another insurer expressed the view that this kind of centralisation can be perceived as too bureaucratic, especially when new acquisitions must be absorbed in to the business.

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At INS_3 we heard that their own local crisis had preceded the financial crisis and resulted in a change of leadership at CEO level. Leading up to the organisation's crisis there had been significant offshore exposure and red flags were raised, but overridden. The result was a decision to completely revamp the governance framework from 2010. The experience led naturally towards greater centralisation of governance and standard setting, particularly around integrated capital management. The guiding role of the parent company was reinforced via a transformation process that included a new manual of what could and could not be done, together with new policies and related compliance work. This new risk governance order involved members of the group executive team sitting in the different business boards. It also meant looking at big remuneration payments more critically.

Risk information management

The problems experienced at many financial organisations, such as UBS, Barclays and HBOS, reveal considerable informational fragmentation and a failure to consolidate risk information, sometimes even at the simplest level of counting types of assets and commitments. This was confirmed to us during an interview at REG_1. The failure to connect up disparate sources of risk information is also dominant feature of the general analysis of disasters and accidents (Turner, 1978) and we were struck by the centrality of this theme in many financial organisations. The issue is not just technological; it is also organisational. We heard that the quality of risk data aggregation is a good 'dip-test' of the state of organisational risk culture. Monitoring and hygiene work of this kind is not glamorous but may be regarded as the foundation of organisational risk culture and a key work stream for the oversight units. One of our interviewees made a similar point in relation to keeping Business Continuity Plans (BCP) up to date. More generally, the maintenance of risk infrastructure in the form of policies, standards and authorities was also seen as an essential component of risk culture, providing central units with standards against which to enforce.

Our enquiries revealed that risk information was not only important in flowing upwards to oversight functions. All our participant organisations were concerned to break down silos and to encourage lateral risk information sharing in one form or another. In one organisation, this took the form of an open system with the idea of repositioning risk reporting and moving it away from the extreme of 'whistle-blowing' and transforming it into internal knowledge sharing via a central data repository. This journey to openness would be achieved by organisation-wide training programmes because it was seen as important to avoid the wrong kind of reaction.

At INS_1 the centralisation of information created 'tighter control over big earners' who were made to understand that their own rewards depended on the lower risk-return activities conducted elsewhere in the group. This is an example of how risk information centralisation supports a rational portfolio approach to the activities of the business as a whole and enables portfolio-relevant discussions with specific business units. Indeed, in one investment bank, a new oversight unit is actually called a 'portfolio group' because its role is to collect different information feeds from the business and to construct a group risk profile. At a large banking institution which escaped the worst exposures of the financial crisis, we heard that the micro-risk work on specific risk categories (liquidity, credit, operational risk, etc.) was well carried out, but that macro-level concentrations within and between these risk categories had not been well understood, and that this was now the focus of the new oversight unit. In addition, the unit was empowered to take 'deep dives' on specific issues of importance, using the data supplied by the first-line risk management function (see Chapter 4).

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Summary

The financial services industry is not the only one in which trends towards greater centralisation are visible. At a large global industrial company which had experienced some major accidents in its recent history, we observed efforts to enhance central risk control on the basis of a new risk management framework regarded as a non-negotiable aspect of operational practice, reinforced by videos and presentations by the CEO and CFO. Moreover, in the airline context, we learned that clear safety management required a high degree of knowledge based centralisation for operational risk management.

Within financial services the pendulum has currently swung in favour of greater centralisation, and boards of financial entities want to be reassured by strong centralised group functions. However, this section has shown how centralisation involves a combination of different things such as new structural relations (e.g. TLD), new oversight units and greater integration of risk information. But centralisation is never perfect and stable. For example, where central functions are perceived as failing to react appropriately to upward flows of information, these flows may be inhibited in the future, as the local subsidiary attempts to wrestle back a degree of independence. Moreover, the current trend towards centralisation may only be temporary. The following quote, from a senior manager in INS_2 illustrates this point vividly:

"... So you know, it shows that there is no right answer here, which is probably why organisations do tend to move from one model to another model. I saw that myself when I worked for [company name omitted], in the space of two years we sort of went from a centralised, a decentralised back to centralised again ... you know and you sort of lost track where you were."

In the context of this study, these different faces of centralisation provide the broad context for more specific risk culture change programmes. In the remainder of this chapter, we identify two broad styles of pursuing risk culture change and outline the trade-offs at stake in these change programmes. These trade-offs will be addressed in more detail in the following chapters.

Risk culture and trade-offs: an overview

There is a considerable variety of organisational approaches to risk culture. In some cases, it has involved incentivising desired behaviour by expanding performance metrics. In others changes have more of an ethical flavour. Some organisations have used consultants and other advisors while a number of organisations have adopted a do-it-yourself approach to risk culture. We also have formed the impression that the composition of risk teams and their internal networks has become fluid around risk culture. Attention to risk culture involves expanding the list of usual suspects in the risk management arena and, specifically, human resource and remuneration specialists have found a seat at the table.

This observed variety, to be discussed in more detail in the remainder of this report, suggests that financial organisations are still finding their way in figuring out their approach to risk culture. It also suggests that 'risk culture' is not a thing with well-defined features but something that organisations perform and pay attention to in different ways. We have been very wary of definitions in our investigation and we do not view the emerging

Chapter 3: Findings Overview

field of risk culture as being standardised in the near future, a view that contrasts with some of the practitioner actors in this space. Indeed, we have seen that organisations are assembling approaches to risk culture from a variety of pre-existing operational elements and managerial routines – employee questionnaires, risk maps, KRI enhanced performance management templates (e.g. balanced scorecards) and so on. For some, this means that risk culture just becomes a new label for old wine, namely making enterprise risk management work properly. From this point of view, risk culture is in fact an empty and far from unique concept which draws heavily on conventional management thinking, and is filled out and literally realised and operationalised by financial organisations via their established change programmes, a point borne out in our review of practitioner literature in Appendix C.

We understand why some academic commentators (e.g. Alvesson, 2002) suggest that culture cannot be managed in a conventional way, and as we note in chapter 4, we have some sympathy with this. But we don't find this to be a helpful place start our investigations despite its salience. In our study we have preferred to observe, as best we could given our methods, the various efforts by organisations, including regulators, to bring risk culture into view and to make it real and subject to change. Despite the great variety of ideas and approaches to risk culture that we have encountered, we have found a number of patterns in our data.

At a high level, we have detected a difference between what we call organic approaches to risk culture and more formal approaches which we call engineered programmes. These two categories – the organic and engineered - are ideal types but they help us to classify risk culture work streams in financial organisations at a high level. The former tend to be self-driven, over longer timescales, involving the consolidation of existing information sets, and a greater emphasis on interaction between risk and the business by organisations who generally have confidence that their risk culture is in good shape. The latter are advisor and regulator driven, with more of a focus on short-term change, using metrics and performance incentives by organisations who seek to 'do something' about risk culture.

Below this high level categorisation, we organise our detailed observations in terms of six recurrent tensions or trade-offs. Earlier in this report we made the preliminary and simplistic assumption that risk culture could be understood prescriptively as the organisational choice and self-understanding of its position in a trade-off between risk-taking and control. Furthermore, this trade-off can be thought of in terms of a bandwidth of acceptable variation in risk and control boundaries. However, this was simply a theoretical model to give our investigations an initial orientation (see our interim report). Our data suggests that organisations operate with a much richer set of trade-offs and either consciously or unconsciously adopt certain positions within them. The trade-offs that we have observed suggest that risk culture, however operationalised, is not a fixed ideal equilibrium for any organisation. It is inevitably dynamic and changing, subject to many different forces. This raises the question – to be considered in the conclusion – of whether this dynamic is a force that could be under the rational control of organisations or whether these organisations are fated to drift according to fashion and the business cycle.

The six trade-offs which concern the remainder of our findings are as follows:

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- **Trade-off 1:** Balancing the commercial and regulatory authority of the risk function
- **Trade-off 2:** Balancing the use of formal organisational arrangements with interactive approaches to risk management
- **Trade-off 3:** Balancing risk support for disciplined business decisions against the risks of imposing excessive controls
- **Trade-off 4:** Balancing the use of advisors with 'going it alone'
- **Trade-off 5:** Balancing regulator and regulated culture
- **Trade-off 6:** Balancing ethics and incentives as levers over behavioural change

These six areas where trade-offs are present are not the only possibilities, but they are the most visible from our data. We know from the existing practice and academic literature that it is easy to be prescriptive about risk culture (and in the period 2011-2013 we have seen an increasing amount of prescription). In contrast, consistent with the approach outlined in Chapter 2, we aim to explore the choices made by organisational actors within each trade-off, the pressures which shape organisational and individual attitudes and choices and their organisational implications.

The focus on trade-offs also adds texture to the organic / engineered distinction between approaches to risk culture. As illustrated in more detail in the chapters which follow, organisational choices around these trade-offs tend to be aligned to either an organic or a more engineered approach to risk culture. Organic approaches focus on risk in the business, involve a more interactive risk management style, allow for judicious risk-taking within limits, use consultants less, are more likely to resist regulatory standardisation and will tend to favour an emphasis on ethics and mission. Overall, organic approaches imply incremental change to risk culture over longer timescales.

In contrast, engineered approaches favour shorter timeframes for change and are characterised by an emphasis on strong centralisation and risk management authority, as well as more formal approaches to risk culture, often with the help of external advisors. Engineered approaches may generate more conservative approaches to risk which are more closely aligned with regulatory risk appetites and which adopt formal incentives-based levers for behavioural change.



Figure 4: Risk culture approaches and trade-offs

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Figure 4 develops the contrast between approaches to risk culture and provides a way to position our participants in a risk culture space, at least provisionally. We do not judge whether one position is 'better' than another and we certainly do not regard the organic as in any way superior to the engineered approach. Each has its merits and drawbacks as with any trade-off. Rather we provide a conceptual map of risk culture change programmes that can be useful in highlighting some of the design choices that financial organisations must face.

Finally, the many examples of apparently bad and failed risk cultures have tempted commentators to believe that a 'solution' in the form of a unique good risk culture can be found. We do not share this view and believe that any quest for such a risk culture Holy Grail will not prove fruitful. However, we do think that an understanding of the trade-offs organisations face when attempting to 'manage' their risk cultures enables the formulation of prescriptions, in the form of simple questions for practicing managers and staff, which may be more useful and targeted.

Chapter 4:

The Authority of the Risk Function

“The second line, it’s very difficult to necessarily define exactly what that role should be. So what am I? Am I the policeman, am I the friend, am I a critic? And it’s ... and because the second line has tentacles all over the business and has a good understanding of what’s going on, it’s a very, very difficult role to actually describe to say well I’m your friend but actually I’m going to do other things to you if you don’t do X, Y and Z. And how do you do that is difficult. And I imagine most risk functions are in that sort of middle ground where they’re trying to ... they’ve got to work with the audit, the independent and they’ve got to work with the business and it’s facilitating and understanding what’s going on.”

Our investigation suggests that a significant aspect of the risk culture debate closely concerns the organisational position of the risk function. Interviews with managers who work in risk management raised a number of dilemmas regarding their authority, expertise and roles within their organisations. The opening quote, taken from our conversation with a CRO, is indicative of this ambivalence – e.g. the ‘policeman’, the ‘friend’ or the ‘critic’ – of the risk manager role. And this in turn has significant implications for the interaction between risk personnel and other parts of the organisation. The key questions are: what should risk managers be responsible and accountable for? How close should the risk function be to the business? Which kind of expertise is desirable to satisfy required tasks and responsibilities?

How organisations and individuals address and answer these questions has cultural implications, reflecting different values, norms and assumptions around the way in which an organisation (or different parts of an organisation) sees and acts on risks. Moreover, answers to these questions have implications for the expertise of risk personnel, a question that represents an open debate for practitioners and scholars (notably the lack of authority of their respective risk functions which were identified as issues in the Barclays, HBOS and JP Morgan cases highlighted in Chapter 1). At the heart of the issue is the authority of risk personnel, and the degree of friction and/or respect between front-office and risk management teams.

The quote above emphasises the problematic role of the second line, an issue that was already evident in the initial interviews that informed our interim report and touched upon in Chapter 3. In the interim report (Ashby, Palermo and Power, 2012) we suggested that key issues are played out at the interface between what are called the first and second lines of defence. Significant challenges in operationalising this interface include the ‘risk’ of risk people being captured by business units (‘going native’), and concerns with the reporting of risk issues by the first line. The perceived challenge is to avoid punitive actions that may prevent managers from openly raising issues of concern.

The themes of the authority and expertise of the risk functions are intertwined with other thematic sections of our report, especially those on centralisation and interaction (see Chapters 3 and 5). In this chapter we focus specifically on how attempts to expand the authority of the risk function are interrelated with changes in the expertise (or expectations around the expertise) of risk personnel.

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The literature distinguishes between two types of risk manager (see Power, 2007; Mikes, 2009). On the one hand, risk managers can be technical experts of one or several sub-disciplines of risk management (e.g. financial, safety, information technology risks). On the other, especially with the rise of a holistic conception of risk and risk management, risk managers can be seen as change facilitators and business partners. In the latter case, what really matters are relational skills rather than 'technical' and abstract bodies of risk management knowledge.

In all our data, we notice the tendency to embrace the second approach, with an emphasis on getting closer to being a 'business partner' and/or 'internal consultant'. We consider this finding significant as we spoke to risk professionals occupying different positions in different functional areas of risk management (e.g. Chief Risk Officers, ERM, operational risk, risk and compliance, risk oversight) across a variety of organisations. Specifically, we heard of the need for risk people who were experts in the business, a theme which recurs in all our sample organisations. We heard in several organisations that risk specialists tend to be "too bogged down in detail" and bound up in a data driven organisation, and that there is a need for people who can think laterally about how to improve the current control environment, rather than simply collect and process information.

Nonetheless, we also noticed that this ambition toward 'business partnering' can be put into practice in different ways, which can be schematically categorised in two ways, which we call 'partnership builders' and 'partnering overseers'. We expand on these two categories in the remainder of this chapter.

Partnership builders

Part of our empirical material suggests that the risk function organisational footprint can be expanded by making debate happen and by obtaining membership of key committees. This is a pragmatic approach that aims to build internal trust gradually and to increase interaction between risk staff, senior managers and front-office personnel. Hence this approach can be related to those in favour of stronger interaction, as discussed in Chapter 5.

Several interviewees acknowledged the communications challenge involved in increasing the footprint of risk management. Risk functions that waste senior management time lose credibility very quickly. As put by one interviewee:

"I have a two-hour slot with the Group Executive every month. I chose to cancel last month's because I didn't think I had enough of significance and urgency to utilise their time. It's a two-way street, I get the time I ask for but you need to recognise that as much as I know I've got that slot, I'm not just going to come in and talk to you unless I've got material things to talk to you about. To keep their engagement and trust they need to know that I won't unnecessarily waste their time."

Another way to expand the footprint of risk management has been to obtain membership of key committees. One senior risk manager we met in our initial round of interviews noted that regrettably there had been no risk member in one key senior-level committee. This view was reinforced by another interviewee who noted that traditional committee structures tended to segment risk thinking whereas 'good' risk management was implicit in every committee and not just in a 'risk' committee:

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“You go to a management meeting and you talk about management issues and then you go to a risk committee and you talk about risk issues. And sometimes you talk about the same issues in both but people get very confused and I don’t know ... I don’t know how right it is but I really think you should be talking about risk when you talk about your management issues because it kind of feels to me again culturally that’s where we are.”

As for the point raised on communication, membership of key committees is dependent on making sure that risk staff can add value to the meetings. At BANK_1 the point was made that the CRO has no ‘divine’ right to participate in the big decision-making committees. Paraphrasing one interviewee, *you have to add some value to get to the table in the first place.*

The approach embraced by these individuals was clearly focused on improving relations with the business, but in a gradual way by building on existing relationships, processes and structures. An indicative example of this approach is provided by the efforts of a manager in charge of risk culture change in INS_4 (notably these efforts were in addition to a number of other activities that took most of her working time). From our meetings with this manager (two over the research period), we noticed what might be defined as a pragmatic approach to expand the risk management footprint and to instill ideas and values that relate to risk culture within different parts of the business (see box 11). This person recognised how, in a cost-constrained environment, it is not always possible to change radically the organisational structures or to implement new processes. Nonetheless, organisations do have a number of processes, activities and ‘levers’ that can converge on risk culture-related activities. The interviewee commented that she would always respond in the following way when colleagues mention that not much is explicitly done on risk culture:

“... Most of you are not starting from scratch, you have already a number of things there, what you don’t know is how those are connected holistically and where they are facilitating the right risk culture ... it’s more about creating alignment.”

This means that the skills of a risk manager, who aims to work her way through the organisation, involves ‘connecting the dots’ between apparently disparate initiatives that may have implications for risk culture. Internal staff surveys and customer satisfaction surveys may be good sources of data readily available to create a set of meta-facts about risk culture(s). The risk manager must be skilled in understanding what this data is about, but most importantly, she has to be able to recognise that much of this data already exists in the organisation and that the challenge is to connect it to higher level values and norms. In so doing, the risk manager will necessarily interact with other functional experts, such as HR staff, and will provide her view on various on-going change initiatives, related for instance to training and remuneration. An indicative quote is the following:

Box 11: Questions for the ‘pragmatic’ risk manager

“Who is driving remuneration? Are they taking the right approach, the right incentive? How are we articulating the risk appetite? Who is driving the training? Is the training including risk capabilities?” (Excerpts from our conversation with a risk manager)

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“ ... So now we are looking at the remuneration metrics and going through the remuneration committee and now is the time to get involved on that. I'm very involved on risk training, so now I'm kind of from the risk financial perspective, I'm the content expert on the risk training ... but in HR we have somebody driving all the development programmes, so I just need to work with them, challenge them, making sure that they have alignment ... ”

Partnering overseers

A similar emphasis on business partnering, although via a different approach, emerges from interviews within a second group of organisations. Here the emphasis is put on more visible and clearly articulated change programmes that aim to clarify risk management-related responsibilities and activities. Among such initiatives we notice training programmes and structural organisational changes. Hence this approach links nicely to the issue of centralisation discussed in Chapter 3.

The interesting aspect of risk training initiatives is how they imply a different conceptualization of how to reduce the distance between risk and business people. Whilst the 'partnership builders' try to get themselves closer to the business, obtaining membership in non-risk committees or seeking out who is responsible for non-risk related change initiatives that may connect with risk culture change, the 'overseers' aim to get non-risk personnel closer to the activities and concepts used by risk people. In effect, the 'overseer' tries to mould non-risk personnel into becoming lay risk managers.

Two indicative examples of formal training programmes relate to efforts in BANK_3 and INS_4. At BANK_3 our discussion of risk culture began with a new framework that would clarify exactly what it means for risk management to be owned by the business. We were told that ideally, everyone must feel like the CRO of the bank and that the central risk management function was there to facilitate. The CRO of this bank felt that the UK was far behind other countries in its philosophy of risk training, which reinforces silos rather than trains individuals for cross-functionality. The CRO also decided that there needed to be separate training for particular regulatory areas (for example, certain operational risks such as fraud and anti-money laundering) and for risk culture, which included new initiatives in risk training for non-risk people via a risk academy. The CRO claimed that there was little resistance to attending such programmes – perhaps because of the strong focus on training in the organisation generally.

At INS_4 there were big changes during and after 2007. Risk personnel worked with HR developing an entirely new model, which was considered very much grounded in the TLD model (Chapter 3), thus reinforcing the view that 'overseers' stress clear articulations of tasks and responsibilities. According to the different interviewees within this organisation, what was considered a 'quite sophisticated' training and accountability infrastructure was built to support risk management policies and standards that set out the minimum requirements expected of the business. We were also told that there seemed to be little resistance to the implementation of this infrastructure, with good reactions from the first participants, coupled to strong leadership support. In addition to the formal training plan, the Solvency II regulatory agenda was used to raise the profile of risk management and many personal objectives and bonuses were made dependent upon delivering the organisation's risk management plan. This was backed up by a big focus on communication, such as a risk-dedicated website which, according to one interviewee, attracted the most hits of any portion of the internal site, and the introduction of a risk category into the employee engagement survey, to answer four questions about risk management within the company.

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There is little doubt that the structural changes outlined in Chapter 3 are correlated with efforts to increase the organisational authority of the risk function, with implications for risk personnel expertise. For example, at BANK_2 the decision has been to create a new structure, separate from the more traditional day-to-day risk management and reporting directly to the Board. The declared aim of the new oversight unit was to create 'lateral thinking', and more forward-looking activities rather than to focus on traditional and more granular risks (e.g. daily liquidity issues). The two risk management-related functions have clearly distinct remits and required expertises. According to one interviewee involved with the risk oversight function, the skillset is not just technical. It involves an ability to maintain relationships. She went on to observe that risk people with an 'audit mindset' encounter difficulties when interacting with the business. They require a more balanced skillset in which they can get people to understand that they have missed something or that they ought to think about something. She emphasised that the business also needs to be open to this interaction. So you need both the right individuals in the oversight function, and also the right individuals on the receiving end, who may have been used to an audit culture in the past.

We also learned that the newly formed oversight team at BANK_2 has the authority to do 'deep dives' on any part of the business (risk, commercial etc.), while the traditional risk management function did not have this possibility. Box 12 provides a brief description of the deep dive as a tool implemented by risk experts within the risk oversight team. In general, members of the risk oversight team were 'experienced' risk people, ideally with some business experience. The ability to make effective deep dives depended on the presence of non-risk related skills, so that different areas and activities of the business can become comprehensible to risk personnel (e.g. Information Technology).

Box 12: Deep Dives

There is no formal selection process for a deep dive. It depends on a range of external and internal factors. As recounted to us, they seem to be primarily a response to uncertainty (about the reliability of information) and regulatory interest (a desire to double check that reported information is correct). Deep dives are generally initiated by the risk oversight function and can touch different functions and organisational areas.

Contingent factors

Partnership 'builders' and 'overseers' share an ambition to expand the footprint of the risk function. In both cases, although in different ways, we were able to trace barriers and contingent factors that affect how risk expertise and authority develop in financial organisations.

First, we heard that risk language is often a barrier to the organisational authority of risk management. At one organisation, there were efforts to animate risk conversations within the organisation using performance-focused language that did not use the 'risk' word. Similarly, one recognised the need for the risk function to invest heavily in relationships with the front-line and to help them to take more responsibility. But it was not just a question of the front-line. One CRO regarded IT and technology as one of the most significant specialisms in the organisation with major challenges for the

Box 13: Risk and operational expertise

Several members of the safety department at AIRLINE have been pilots in the past (and still do fly in some cases). These people have the necessary 'content and background' to analyse the safety data and participate in business decisions.

Chapter 4: The Authority of the Risk Function

risk function. In general, risk managers must be able to speak and understand different languages. Business knowledge seems to be a necessary precondition not only to interact with front-line and other staff functions, but also to understand which language to adopt to enhance authority and credibility. This authority and credibility enables risk personnel to build relationships and networks across the organisation and to aspire to become trusted business advisors (Chapter 5). The personal background of safety staff at AIRLINE provides indicative evidence on this point (see Box 13).

Second, we found that regulatory prescriptions and models can be a significant barrier to an ambition to expand the risk function footprint within the business. The 'independent role' of the risk function is usually considered an important aspect that has to be preserved. Hence, greater involvement of risk personnel within the business can be seen as problematic. It is interesting to note how both approaches address this tension. From an 'overseer' perspective, formal training programmes aim to get non-risk people closer to the activities and mindsets of risk personnel rather than the other way around; while new risk oversight structures separate oversight responsibilities from day-to-day risk management, emphasising the difference between 'first' and 'second' line activities. In contrast the 'partnership builder' approach builds on informal relations without making any visible change in the structure of the lines of defence, the idea being to encourage effective risk management by fully integrating it into the 'normal' management activities of the 'first' line.

Third, we found that ideas and expectations about the 'right' expertise across different organisational levels can vary over time. In our survey follow-up meeting at INS_2, discussion among participants suggested that, historically, the risk function had placed more weight on compliance while senior leadership was more weighted towards the business and its key risks. Over time this perceived gap was decreasing and the risk function was becoming more commercial in orientation. According to participants, there is still a compliance element in the reporting but the vast majority now is focused on "what are the risks telling us and how should we react?"

Fourth, in line with our assumptions related to risk culture 'plurality' and 'drifting' (see Chapter 2), we noticed how different approaches characterise the same organisational setting. INS_4 started with an 'overseer' approach, but then responsibility for risk culture work shifted to a person exemplifying a pragmatic, 'partnership builder' approach. This point raises an interesting reflection on the value of formal risk management processes, models and frameworks in the context of the somewhat episodic journey of risk management arrangements in specific organisational contexts. In our interim report, we noticed, with some surprise, the lack of explicit references to work related to Enterprise Risk Management (ERM) within the risk culture work streams. We hypothesised that ERM was not well aligned with risk culture work. A longer involvement with organisations such as INS_4 would suggest a different hypothesis, namely that the architecture of ERM can be foundational for risk culture work streams and diagnostics. A risk culture programme, no matter how explicit, may help to link together the disparate concepts and tools that compose ERM.

Box 14: *External networking*

Crystallising safety events, however large or small, were used at AIRLINE to build intellectual capital, including the development of relationships with academic safety specialists – all borne out of a desire to learn lessons from these events. The emphasis was clearly on a collective process of trying to find out what happened and why, including, in the case of more minor events and 'near-misses', how particular controls may have prevented a worse outcome and what might have happened had they not done so. Collaboration with a range of research institutions was proudly remarked as a decisive element for safety staff credibility and authority.

Chapter 4: The Authority of the Risk Function

Fifth, risk management expertise can hardly be seen as organisationally bounded. Most of the risk managers we spoke to have been involved in a number of networking activities, participating in initiatives promoted by professional bodies and consultancy firms. Some actively participated in the crafting of risk culture guidance promoted by professional bodies, subsequently disseminated through blogs and public seminars. The amount of contact time with some of the participant organisations suggests that research conducted by academics (and also consultants) can be used internally as a lever to expand the risk function authority. This ambition to leverage external 'expertise' was even more evident from our conversations with safety personnel at AIRLINE (see Box 14).

Summary and Conclusions

Our investigations revealed a wide variety of ways in which the risk function has sought to expand its footprint and authority within financial services organisations. Though the financial crisis has increased business unit receptivity to the voice of risk management, many challenges exist on the supply side of this relationship. Our discussions about risk culture with our sample organisations have revealed an aspiration for a new, ideal kind of risk manager who does not yet fully exist and who must make the journey from compliance towards a more strategic business orientation. By compliance we mean something broader than the compliance function as such, with its focus on specific rules (e.g. client money). Rather we mean a more general compliance orientation to the conduct of risk management, with its focus on drafting policy documentation, completing risk registers and taking its lead from regulatory policy (see also Chapter 8). From our interviews, we conclude that the new kind of risk person must be a number of different things all together: a lateral thinker, business-focused, a trusted advisor; a network builder, cross-functional, challenging and decision-relevant. In general, risk managers must be able to speak and understand different business languages. Business knowledge seems to be a necessary precondition not only to interact with front-line and other staff functions, but also to understand which language to adopt for enhancing authority and credibility. This authority and credibility enables risk personnel to build relationships and networks across the organisation and to aspire to become trusted business advisors. The personal background of safety staff at AIRLINE provides indicative evidence on this point (see Box 13).

Returning to our opening quote, we suggest that risk managers are constantly trying to avoid the 'policeman' approach, and to find ways to become challengers of front-line activities. This can happen in two ways. The first involves gradual change driven by individuals who aim to connect different activities and projects that they consider risk culture-relevant (pragmatists/partnership builders); the second involves a clear and more formalised articulation of tasks and responsibilities by means of training programmes and organisational changes (partnering overseers).

We suggest that the former approach aligns more closely to our idea of an organic approach, with cultural change happening more slowly and progressively, while the latter aligns to an engineered approach, with more visible and rapid modifications. It is an open question which of the two approaches is likely to endure in organisations. We can envisage how a 'partnership builder' approach has the potential to last longer, transforming risk culture-relevant activities into business-as-usual, although this is dependent on the on-going construction of a fragile network of relationships driven by key individuals. An 'overseer' approach is more visible and possibly wide-ranging, although also more at risk of remaining an ad hoc intervention if no sustained energy is instilled across the organisation. In short, structural change in the form of new central units can be created in a relatively short period of time, but authority-building takes longer.

Chapter 4: The Authority of the Risk Function

In both cases, a clear tension emerges in relation to the ambition to get risk managers closer to the business. Problems may arise in terms of relations with regulators, who may prefer a clearer distinction between different 'lines of defence' (see Box 15). Issues of accountability and blame avoidance are also at stake. The key question is whether first line management is doing risk selection, and while second line risk personnel remain the risk owner of last resort. To paraphrase one of our interviewees: when something goes wrong, who do you point to? One possibility, as remarked by the same interviewee, is that risk directors, who may not receive much of the reward when things go well, will take the blame when things go wrong. The creation of networks of local risk champions (non-risk specialists charged with helping to embed risk management frameworks in front-line activities) can also be problematic, although often evoked as a solution to the problem of risk management embeddedness. Various interviews suggested that some caution should be taken. As put by a CRO we interviewed, the reaction of people in the business would often be: "Oh we can relax now because they're going to take it on."

Box 15: *Risk authority and the TLD model*

The ideal of the risk manager, as business partner, points to a significant tension in risk culture change processes, namely the need for the development of risk management capability which cuts across that model. Under the TLD approach risk oversight is separated from business level risk and control decisions, but its authority may be more fragile, because of reduced opportunities for collaboration. The balance between authority with the business and independence from the business is a fine line. Hence, key issues in risk culture are played out in the process of determining this balance.

Risk culture challenges for CROs, CEOs and Boards

- How would you monitor changes in the internal authority of the risk function? If you don't want to do this, why?
- Is the current balance between informal relationship building and formal training of the business in risk understood and consciously chosen? Does the risk function have a role in the design and implementation of risk training programmes?
- Are you recruiting and training risk managers in the different languages of the business or is there still an underlying mono-culture within the risk function? In the latter case, have you ever discussed your perception of such culture with colleagues in the risk function?
- Do you generate stories of risk management success and value creation and ensure that they circulate within the organisation and with regulators? Considering the last year, how many of these success stories can you recall?

Chapter 5:

Networks and Interaction

“And I get more concerned that the risk functions are just not interacting enough and do we really know what’s going on? Do we really know how we can help people? We have lots of interactions with the same people and I’d like to be having lots of interaction with a range of people.”

Since the mid-1990s there has been a proliferation of frameworks for risk management. Formalised holistic processes, often called Enterprise Risk Management (ERM), have become orthodoxy. Yet these frameworks did not generate adequate warnings about the financial crisis and both practitioners and academic commentators are well aware of the limitations of such formal frameworks, not least in terms of having real leverage over behaviour. As mentioned in Chapter 2, sustained organisational interaction is a key theme in the management literature, especially work on organisational crises and incidents (Weick, 1990, 1993; Weick and Roberts, 1993). This ‘necessity to talk’ is also relevant in work on management accounting and control, where interactive styles of management control are discussed as part of the levers that managers can use to manage performance and strategic uncertainties. Indeed, drawing on the work of Robert Simons (1999) at Harvard, it seemed to us at the beginning of our study that risk management might be more developed diagnostically in terms of its technical elements and much less developed as an interactive control system (a more human-centred method of control designed to promote conversations about risk), even though all the risk managers and CROs we spoke to emphasised the importance of relationships.

The key tension is between the body of formalised processes and procedures that provide the visible structures for risk management and control and the multitude of human contact time that inevitably happens within organisations. A senior risk manager, whom we met in our initial round of interviews, noted that in her organisation there was a very tight [risk] committee structure, with regular meetings and formal minutes, but that this was only 20% of risk management. The rest was made up of conversations and informal contact time.

Accordingly, our subsequent work has focused on the dimension of interaction or what we call the ‘touch points’ between risk management and the business. In short, we think that the type and frequency of interaction are revealing of different approaches and expectations around cultural issues. We focused in our interviews mainly on the interaction between risk personnel and other parts of the business, although we also collected data on the level of interaction between individuals occupying different roles in the organisation (e.g. senior managers, managers, staff members). The opening quote in this chapter is indicative of the key issues for risk managers reflecting on the need for more (or less) interaction. Do risk personnel get to know what is happening in the business? Can they know more by interacting and meeting with people in the front-line and other specialist functions? But, do the front-line and other parts of the organisation actually want to talk to risk personnel?

From our empirical material, in particular through the combination of survey analysis and subsequent follow-up focus groups, we had the possibility to appreciate distinct attitudes and expectations about the relevance of a ‘high touch’ organisation. Hence we distinguish between touch point ‘enthusiasts’ and ‘realists’.

Chapter 5: Networks and Interaction

An initial empirical basis for this distinction is provided by our survey material. It is possible to compare results from the four organisations that ran a short internal questionnaire. A question asked respondents to rate, over the period of a month, the frequency of interactions by phone (or email), in person or through formal meetings with colleagues in other functional areas (e.g. group risk) and with their supervisors (e.g. business directors, heads of teams). The scale ranged from 1 (never) to 7 (daily). Table 3 shows the frequency of interaction by phone or email within the two organisations that returned a significant number of questionnaires across different areas of the organisation (risk and non-risk functions) and different organisational levels. Results from the responses from staff members only (in parenthesis) suggest that INS_1 (in comparison to INS_2) is a higher touch organisation, where even junior people can get access to senior management (e.g. Heads of Business Units).

	Head of BU	Supervisor
INS_1	4.7 (4.4)	6.3 (6.4)
INS_2	4.8 (3.3)	5.7 (6.2)

Table 3: Interaction, all responses (staff only)

Table 4 provides further data from the same question, providing information on the level of interaction between non-risk personnel (e.g. underwriters, people in the retail business) and risk personnel, either at the group level or the local (e.g. business unit) level. From Table 4, it is even clearer how, considering the relation between risk and non-risk staff, INS_1 appears as a higher touch organisation. The survey follow-up allowed us to uncover some of the expectations and aspirations behind this data, which we explore further below.

	Group Risk Team	Local Risk Team
INS_1	3.5	5.5
INS_2	1.9	3.3

Table 4: Interaction, non-risk respondents

Touch point enthusiasts

Touch point 'enthusiasts' emphasise the relevance of face-to-face interaction with colleagues, while they are more sceptical of the significance of formalised reporting structures and organisational structures as a driver of organisational conversations on risks and risk management. In short they prefer to achieve their risk management objectives through more informal methods, building trust through regular cross-functional interaction between colleagues (not only via scheduled meetings, but also water cooler conversations, etc.).

Chapter 5: Networks and Interaction

At INS_1, upward interaction in the form of access to senior people was regarded as very important to preserve a small company mentality. The CRO felt able to see senior colleagues, including the Group CEO, at any time, but tried to use the time wisely. In addition the risk function has regular training slots with the main Board. This organisation participated in a further internal survey and follow-up workshop. As anticipated in the previous section, results suggested that there was a high (relative to the benchmark) perceived level of interaction between risk and compliance functions and the underwriting side of the business. The CRO was content with our survey result since she herself was engaged in increasing interaction, of which our focus group, attended by underwriters and a range of risk people, was an example.

The survey follow-up meeting, attended by a range of individuals from different parts of the organisation, confirmed that a lack of personal interaction had been an issue in the past, a point raised by both risk and non-risk personnel. However, there was a clear willingness to rectify this. As put by one of the workshop's participants, "certainly one of our tensions with underwriting has been both sides feel there hasn't been enough personal interaction." It was also clear how interaction, even in a context that welcomes contact time, is not frictionless. A point that was raised, and commented upon by many, is that who instigates the interaction is a crucial element. As put by another participant to the seminar:

"It'll be interesting to see who instigated interaction. If I'm an underwriter, am I going to see them or ... because I need to and I want to rather than ... Audit have just turned up."

Hence, there is a difference between interaction which arises as a result of a business invitation and that which does not and may be unwelcome (e.g. when contact is initiated by the risk function to complete a process that the business perceives little value in). We consider this a crucial issue from an organisational risk culture point of view. It is possible to hypothesise that touch point 'enthusiasts' can find it difficult to put their ambition into practice in a context where risk-driven interaction is not recognised positively, leading possibly to increased friction within the organisation.

Therefore, aspirations for more interaction are intertwined with ways of expanding the authority of the risk function and changes in risk personnel expertise. As mentioned in Chapter 4, we envisage two different approaches to promote business partnering within organisations. The lessons from the pragmatic, 'partnership builder' approach, in particular the incremental nature of community building used by the proponents of this approach, seems to be valuable for risk managers who aim to get closer to and talk to the business more, even in contexts that are not very welcoming for risk personnel or organisations where there is no perception of any significant risk issues. In such contexts, the careful building of alliances over time, with people in HR and other functional areas, who are interested in similar objectives, can be seen as a useful starting point to get traction for larger scale changes in the number and quality of touch points between risk and non-risk functions. Interestingly, in the financial sector we did not hear much about the role of technology as an enabler of interaction. Touch point 'enthusiasts' seemed to be strong believers of 'old style' face-to-face meetings. Technology seemed instead to play a greater role in the airline company where we conducted some interviews for comparative purposes (see Box 16 and Box 17).

Box 16: Technology and interaction

At AIRLINE, we observed a highly forensic system with a capability to generate red flag events for investigation. The system encourages and makes easy interaction between those reporting (the front-line) and investigators (the second), but the interaction is mainly virtual. Investigators can recommend actions and track their execution, but rarely meet with front-line staff face-to-face.

Chapter 5: Networks and Interaction

Touch point realists

The practice literature, and most of the academic literature, emphasises the value of organisational talks, open communication and personal interaction (Chapter 2, Appendix C). The touch point ‘enthusiasts’ seem to conform to this view. Nonetheless, data collected from other organisations, including two that participated in our survey and post-survey reflections (INS_2 and BANK_1) helped to further unpack the tensions, contradictions and problematic aspects of greater interaction. In both cases, a more ‘realist’ view of the advantages and disadvantages of closer interaction emerged.

At INS_2 we were made aware of the disadvantages of placing too much value on interaction. The following comment made by one of the participants to the survey follow-up is indicative of the ‘dark side’ of frequent meetings and emphasis on ‘talk’ across a large community of actors:

“... So the way around that of course is to get everybody to be part of the decision in the first place but getting everybody to be part of a decision in the first place takes an awful long time. And I think the other driver, if you go back into history, that engendered some of this into the DNA, was people not wanting to take accountability for anything unless absolutely everybody else had already signed off on it.”

High levels of interaction in this insurer meant that a large number of people tended to be involved in decisions, even those with little materiality. This was driven by a strong desire for consensus in decision-making because of some past experiences, where: (a) key decisions were not widely supported; and (b) accountability for decisions was not clearly owned. In contrast, the current UK culture was perceived internally as too collaborative, leading to slow decision-making at times. At its worst it was pointed out that this collaborative culture can be part of a tactic not to take decisions as, paraphrasing one of the participants to the meeting, *getting people in a group is a good way not to decide*.

At BANK_2, a senior manager also highlighted the downsides of a strong network focusing on the risk that close relations between the first and second lines can cause risk management to ‘go native’ and be ‘captured’. She commented on the need to have a balance between good personal relations and the ‘independence’ and authority of the second line (an observation also made in the Salz review of Barclay’s culture prior to the LIBOR scandal, and in the US Senate investigation into the JP Morgan Whale Trading event). The same person also emphasised that in this organisation, risk management was no longer a ‘speed bump’ on the way to a bonus. According to the CRO, relationships in the UK are good between the first and second line, but risk cannot get too close.

To address the trade-off between interaction and independence, another manager responsible for operational risk commented that she and her team were moving to the first line and will be close to the business (providing what is in effect in-house consultancy), while a separate second line oversight operational risk function is being created at the international group level (which links to our discussion of centralisation in chapter 3). In further discussions, we observed that this person was very pleased to be leading the part of the operational risk function that would remain close to the business so that she could provide ‘real time’ challenge and more tangible strategic value through participating in first line committees. She hoped that this would help to change any lingering perceptions of her role as another compliance function and observed that first line departments are more likely to report losses and near misses where the level of interaction is high – especially non-monetary events, which are common, but can be missed.

Chapter 5: Networks and Interaction

Contingent factors

Whilst we have the support of empirical data, such as survey results on interaction levels within different organisations, the distinction between ‘enthusiasts’ and ‘realists’ is primarily based on senior management views of the benefits and drawbacks of greater interactions. Our data does not allow us to judge the relative effectiveness of the two approaches. Yet, and importantly for our focus on risk culture, the two approaches disclose a different predisposition to assess the value of personal interaction in complex, growing and changing organisations. The former have an almost idealised view that things can be sorted out quickly and effectively by meeting in person; the latter are more cynical of the potential for personal interaction to address organisational problems and highlight issues of accountability and business capture.

As for the other thematic trade-offs, the data suggest that the choice between the two approaches depends on a number of contingent factors. First, interaction is influenced by the physical disposition of offices. In organisations where some of the teams of risk people sit near to front-line personnel (as in INS_1), one would naturally expect more touch points, rather than just consulting the internal manuals and operational procedures. This is not surprising, but is perhaps an underestimated issue in a time where technology helps increase contact time. Organisational changes can rapidly disrupt what is considered a ‘healthy’ amount of contact time, as seemed to have happened in INS_1 as the organisation grew bigger. One person participating in our survey follow-up meeting commented that: “A lot of it happened overnight when we moved buildings”.

Second, and once again, regulatory culture seems to have a strong input on the call for and expectations around more interaction. Historically, staff at BANK_1 stated that it has had an informal culture, which emphasised networks and relationships over formal processes and documentation. Now they have to bring in more documentation and formality, due to regulation. They observed that regulators like formality and documentation, as it can be more easily understood, measured and benchmarked – a situation that could challenge the informal culture that the bank has developed. Our conversations with various advisors reinforced this point of view. As discussed in Chapter 3, regulators tend to prefer clear-cut models such as the TLD and may be sceptical of highly ‘interactive’ organisations, which rely more on informal relationships which blur the TLD approach. However, a formalised governance structure and related accountabilities can also be divisive and hinder the development of trust between the first and second lines of defence in particular (see Box 17).

Box 17: Interaction and the TLD model

At AIRLINE, a senior manager emphasised the importance of building respect in the organisation and having the capability for strong peer-to-peer communication. For example, if one wants to observe a pilot during a flight they use ‘a mate’ [of the pilot] and not an investigator which enables more detailed information to be elicited. In this environment there was very little mention of ‘lines of defence’ since safety was already an operational priority. This suggests to us that the TLD model is not risk culture neutral – it is itself symptomatic of some kind of risk culture failure and of a very distinctive regulatory model which values independence over knowledge and relationships. Interviewees at AIRLINE placed great weight on interaction with the business and were not concerned about any dilution or capture risks, the potential for capture not being a concern when risk and the business share the same objectives.

Summary and Conclusions

There are no shortages of opportunities for risk personnel to meet their counterparts in other firms. The large consulting organisations run many networking events and there are associational conferences of many kinds. In addition, in one of our meetings with the regulators, we had the impression that bank CROs are considered guardians of the balance sheet, and therefore indirectly of systemic risk. Hence, forums for knowledge exchange between CROs and the regulator have also been established. Not surprisingly, the CRO at a large bank mentioned his frequent contacts with CROs in similarly large banks.

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Yet as valuable as these activities are in generating trans-organisational knowledge-sharing among risk personnel, this is different from the interaction that goes on inside financial organisations. We distinguish between two approaches, based not so much on the actual amount of interaction and its presumed 'effectiveness', but mostly on the expectations and aspirations around interaction, as a way to manage the business and its risks. Touch point 'enthusiasts' emphasise the relevance of face-to-face interaction with colleagues. They are more sceptical of the significance of formalised reporting structures and organisational structure as a driver of organisational conversations on risks and risk management. Touch point 'realists' do not underestimate the relevance of interaction, but point, even with some cynicism, to its more contradictory consequences, such as lack of accountability and slowness in decision-making. Furthermore we did not find interaction to be necessarily conflict-free. On the contrary, we suggest that an active touch point culture could be expected to generate more organisational friction than one which is passive. We also suggest that this internal interactive capability may sit uneasily and even be damaged by a 'regulatory mindset' concerning the importance of the TLD approach, which is shared by some regulators, advisors and risk managers.

In terms of our distinction between organic and engineered risk culture change initiatives, we see from our empirical data an alignment between those embracing a pragmatic approach to expand the authority of the risk function and touch point 'idealists'. The latter can be seen as embracing a view that organic processes are a more feasible way of changing risk culture. On the contrary, touch point 'realists' emphasise issues of accountability and the need for formal and visible evidence to show to the regulators, which positions them closer to engineered initiatives around risk culture.

Nonetheless, the theme of interactive capability in risk management is one of the most difficult in our study because it is the least visible. Therefore, any attempt to model interaction types may result in the stretching of our current data. Although we know from the literature that interaction is an important dimension, and most of our interviewees confirmed this view point, we did not find any organisations which were explicitly trying to track some aspect of their 'touch points' with the business; their grasp of this dimension of their activity was largely qualitative. While these 'touch points' were acknowledged as important, they were not yet regarded as salient organisation facts in most organisations – and will not be so until they can be measured in some way. We encountered scepticism about the value of interaction as such, and concerns that one can have too much of it and either go native or become an irritant to the business. The tension between the widely agreed relevance of interaction and the difficulty in devising and handling measures of it, reflects the broader tension in the whole approach to risk culture discussed in Chapter 2.

Risk culture challenges for CROs, CEOs and Boards

- Can you name one or two individuals doing risk culture relevant work in your organisation? If yes, where are they (e.g. risk, audit, business)? How often have you talked to them? Do you feel you give them enough support?
- Would you be interested to know whether and how interaction between your risk function and the business is changing? If so, how could you find this out?
- Do you track how many times business functions approach Risk for advice and partnering? If not, why not?
- If you have implemented a TLD approach in your organisation, do you think this has made interaction between the business and Risk more or less likely?
- Are you worried about a lack of interaction between Risk and the business? If yes, why? Can you think of concrete examples of situations where more interaction would have helped to address business problems? Or examples where too much interaction has slowed decision-making?
- Do you consciously translate risk appetite issues into a language which business units can understand and own?

Chapter 6:

Between Risk and Control

“Certain things have rules and procedures and guidelines and ... they set the boundaries and we empower people within them to make the right decisions ... there’s discretion within a set of parameters.”

The issue of appropriate risk-taking has been at the centre of debate since the financial crisis. Cases of bank failures, along with subsequent scandals affecting the likes of Barclays and JP Morgan seem to provide incontrovertible evidence of reckless risk-taking, with disastrous consequences for organisations and the wider economy (for example: House of Commons Treasury Committee, 2009; Parliamentary Commission on Banking Standards, 2013a; Salz, 2013; Permanent Subcommittee on Investigations, 2013). For this reason, much of the tacit understanding underlying the discussion of risk culture in particular and culture in general, has been to find ways to curb this excess via improved controls and appropriate remuneration structures (see our practitioner literature review in Appendix C). Yet, in keeping with our theme of trade-offs developed above, and to maintain a symmetry in the understanding of risk culture, the mirror image of reckless risk-taking is excessive control, or as we have heard some practitioners call it: ‘gold-plating’. How many times do we hear that risk-taking is necessary for value creation without real clarity about how the balance between risk-taking and control in its broadest sense is arrived at, a balance which defines the net risk position of the organisation?

The idea of risk-taking and control is somewhat abstract and difficult to address in practice, although it is central to prior work on risk culture (e.g. Bozeman and Kingsley, 1998, Simons, 1999). In our preliminary interviews we noticed how the discussion often shifted towards the boundaries and limits around risk-taking. The quote which opens this chapter is illustrative of these reflections. When asked about issues around risk-taking and control, our interviewee – a senior risk manager at an insurance company - brought to our attention notions of discretion, boundaries and empowerment.

We used short surveys, run in four organisations, to elicit further reflections and discussion about risk-taking and its limits rather than assessing and comparing different levels of ‘actual’ risk-taking. Specifically, the survey questions explored perceptions around different aspects of risk-taking. Respondents were asked to express their view on the following statements: ‘Most employees are not hesitant to take risks’, ‘Judicious risk-taking is positively recognised’, ‘Risk-taking affects positively compensation/career advancement’. We noticed variations in the response to these questions, but most importantly variations in the discussions stimulated by these results. Specifically, two approaches seem to be culturally relevant, with implications for the role and authority of the risk function.

While some of our participants addressed the topic of risk-taking in terms of the articulation and enforcement of trading limits, a specific dimension of risk appetite, others approached the issue in terms of the reach of compliance into the organisation. This difference may seem rather small but we think it is culturally significant and reflects very different starting positions for thinking about risk culture. Is the risk culture essentially focused on the quality of business decisions, bounded by limits? Or is it essentially focused on the limits themselves and compliance with them? This is a subtle difference but it reflects a difference between what the risk management function places in the foreground and what is in the background. We describe this difference in terms of two contrasting expressions we heard during our interviews, namely the role of risk management as a ‘sandbox guardian’ or as a ‘gold-plater’ of rules and regulations.

Chapter 6: Between Risk and Control

Sandbox guardians

Paraphrasing the CRO during the survey follow-up meeting at BANK_1, risk-taking is considered OK *providing it remains within the stated risk appetite*. All participants concurred that discussions on risk-taking should be phrased in terms of clarity of risk appetite. As stated by a senior manager, the key question would be “Is risk appetite well defined?” If the answer is no, then the follow-up questions would be “Is it too conservative?” and “Is risk management embedded in the business?” Another participant in the meeting underlined this point using the metaphor of the ‘sandbox’. According to this person, “people can play within the sandbox”; senior management and the directors are the “guardians of the sandbox and the toys within it”. We found the metaphor interesting and culturally significant. For example, it may be important for the identity of the risk function to think of the traders as children liable to misbehave when left to themselves, rather than as superstars. The CRO went on to add that there is a very strong limit culture in her organisation – much stronger than at many banks. But there is freedom within these limits, as the company is in the business of taking risk. However, she agreed that BANK_1’s risk appetite is lower than many banks and more homogenous across the group. In terms of our bandwidth model of risk appetite (see Chapter 2), this organisation seems not to have aggressive business units which push at the limits. Moreover, our conversation in this organisation touched on a specific element – business growth and acquisition strategies – that makes the risk-taking and control notion quite practical (see Box 18).

Box 18: Risk-taking and acquisition strategies

Acquisition strategies can give rise to problems of cultural digestion. A quick way to expand in new businesses is to acquire entire teams, but then it is hard to know what you are bringing in (a potentially destructive risk sub-culture). New people may bring new clients with them which is positive, but their motivations are also important. Often people are hired on a probation period to find as many clients as possible in one year – which could promote a short-termist attitude and reckless risk-taking. This suggests that an important aspect of risk culture and one of the so-called ‘moments that matter’ is the point at which new entrants join an organisation and how and whether organisations really understand what this does to the risk profile of the organisation.

We found a similar story about the centrality of limits to risk-taking at a number of the other organisations. For example, a senior risk manager we met in our initial round of interviews told us about the various risk policies in force which specify what can and cannot be done, and for which policy owners must demonstrate compliance. This organisation was characterised by a significant number of policies and procedures which affected many aspects of the business – reflecting a strong desire to limit the potential for risks that could significantly threaten its mutually owned assets.

At INS_1 we learned that authorities and limits for each individual underwriter around the world are set by a group of individuals. There is a similar investment oversight committee for traders. It is regarded as completely unacceptable for people to act beyond their authorised plans, even if they make money. However, every effort is made not to micro-manage risk profiles. Insurance markets are dynamic and naturally create challenging discussions about limits. During our survey follow-up meeting within this organisation, discussion focused on the balance between discretion (in be able to accept certain risks) and compliance. This company felt that it permitted more discretion than other organisations but this was really discretion within certain boundaries and operating guidelines. Risk-taking was regarded as too emotive a term and we were informed that it was important to distinguish between “taking a chance” as compared to “calculating something and then accepting the risk and controlling it.” This suggests that limits may be well-developed for well-understood risks, with strong foundations in data which can be routinely calculated, as compared with emergent and more idiosyncratic risks. As put by a participant to the meeting:

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“... It depends what you mean by risk-taking, as an underwriter I would say we know what we’re doing, it’s calculated, well-judged, so we’re not taking a risk. I would mark myself quite low for that reason.”

In summary, the ‘sandbox guardian’ use of limits reflects a more organic way of thinking about risk culture. The limits are formal devices of course, but they are there to enable risk-taking business as usual. This involves leveraging risk appetite as a key control at the centre of risk culture rather than allowing layers of control to build over time into a default compliance machine. However, we do not pretend that any of our participating organisations were pure ‘sandbox guardians’ in this sense, but the concept provides a useful contrast to gold-plating discussed below.

Gold-plating

At INS_2 we were informed that risk-taking and control were driven from a broader range of cultural elements, such as how many people you want to engage in a decision, how much capital you’re prepared to lose and so on. At the survey follow-up within this organisation, our discussion of the balance between risk and control was framed primarily in terms of attitudes to compliance. Survey results suggested that the local risk culture was more focused on compliance compared to the benchmark companies in our sample. It was agreed that, while the Group as a whole has a compliant culture, the local culture tends to be even more compliant than the rest of the Group. One participant in the workshop argued that she was ‘a little bit concerned’ that the score was low for external regulatory pressures, but that it was high for internal group policies.

The idea of ‘gold-plating’ was mentioned several times by the participants in the workshop. As put by another senior manager: “I think as a senior team we do recognise that we gold-plate or platinum-plate at times, quite a lot of the time.” This was explained in broader cultural terms such as a British tendency to follow the rules. For example, the local unit has fewer risk management policy waivers or concessions than any other part of the Group. Although managers may complain about, and challenge, rule-making at the design stage, there is a general acceptance of outside rules once they have been established.

One explanation offered during the meeting for a lack of risk-taking, despite a perceived no-blame environment, was that risk-taking can be a difficult thing and takes effort: “because by its very nature you’re doing something different to the norm”. We find this comment illuminating from a cultural point of view. Drawing on our preliminary work and large scale survey findings, we suggested that regulatory pressures are having a considerable effect on risk-taking, favoring a risk-averse mindset. The discussion around platinum-plating suggests that organisational cultures can be part of the story. Risk aversion and a precautionary approach to the business can be, at least in part, self-imposed by organisations who mistakenly blame it on the regulator. As put by one participant in the workshop:

“... If you look on the intranet and all of the communications we put out to people you know, the vast majority of them are around processes, procedures, do this, do that. And the balance in terms of looking outward and our customers had got lost at a point. I think it’s changing now but nevertheless. And it comes in from all sources. It’s just constant I think.”

Our survey also suggested that senior levels of management perceived a high degree of compliance-orientation and less empowerment which might impact on how escalation mechanisms would work. This compliance orientation could be explained by its emphasis within training programmes. It was recognised that more could be done to reinforce perceptions around the potential upsides from risk-taking (risk-taking was generally perceived as a negative). It was also admitted by one participant in the survey follow-up that they needed to apply more ‘common sense’ and achieve a better balance between creativity and control. The CEO expressed concerns that compliance requirements (both internal and external) were limiting the creativity of senior management and their willingness to take risk.

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In summary, the essence of 'gold-plating' is the expanded and expanding reach of compliance into the organisation. This is a trend easily associated with our concept of an engineered approach to risk culture but is also itself in danger of drifting as new layers of compliance activities and policies increase through ad hoc change programmes initiated by regulators and central group functions. As with 'sandbox guardians' we do not pretend that organisations are pure cases of gold-platers. These are two ends of a spectrum and most organisations will be a mix. However, we think it matters greatly to risk culture whether the 'voice' of one is more prevalent than the other, and where in the organisation this is found.

Contingent factors

Our observations are necessarily contextual and dependent on the specificities of our participating organisations. In the context of our discussion on risk-taking, we wish to highlight three elements. First, issues of scale are always important. UK subsidiaries of overseas groups may tend towards more of a strong compliance based approach to risk culture, perhaps reflecting the necessity of strong central group control, coupled to, in one case, a British approach to rules. From this point of view, risk culture is imagined and realised as a form of control mechanism, rather than an enabler for effective risk-taking. Risk appetite in such a setting comes to be conceptualised primarily as a system of constraints on decision-making. At the group level of another less international and more compact insurance organisation there was clearly more flexibility to have discussions about limits and appetite.

Second, an important contextual factor for insurers is the need to distinguish life insurance from general insurance. For example, there may be more preparedness to take certain market and pricing risks by life insurers, partly out of a need to generate positive long run returns for investors, and partly out of necessity, because in the case of life insurance, pricing and investment decisions can be problematic for decades (as Equitable Life learned to its cost in the guaranteed returns it offered on certain pension and endowment products). We also heard that underwriters in general insurance were somehow perceived as the 'real men' (an expression used with irony) in the sense of being the only real risk takers in general insurers, thus they generally dominated these businesses. In contrast risk specialists in life insurance, who are largely actuaries, do not have such an elevated status internally, as risk-taking is more pervasive (and perhaps also because actuaries have less of a front-facing, new business acquisition role than underwriters). So, risk-taking is also dependent on the type of product, market and expertise group. For defined product risks (e.g. well understood products such as motor insurance), then there may be tight controls and clear rules. But for other less well defined risks such rules are difficult to specify and more generic risk exposure limits, rather than explicit controls on decision-making, become much more important.

Third, often discussion of risk-taking seemed to be framed in terms of a contrast with other organisational settings that became exemplar negative cases. Hence, perceptions, values and expressions around risk-taking were far from being context neutral. Stories of 'reckless' risk-taking pervaded the language used by participant organisations in describing their own areas of responsibility. A side comment to the survey's questions on risk-taking in one organisation is indicative: "Adoboli took risks...look where that got him." Moreover, the case of Lehman Brothers was mentioned very often as a point of contrast in our discussions, since some of our interviewees had worked there and so had inside knowledge. One of these individuals accepted the idea of 'judicious' risk-taking (understood as an appropriate degree of risk for an appropriate return) which contrasted with the strong returns (revenue generating) emphasis at Lehman Brothers. According to this person, the front-office at Lehman had been free to make both money and a "mess", which others had to "clear up". As a contrast, in her current organisation not reporting to the board and failing to keep them in the picture would be "unimaginable" and would lead to someone being fired straight away.

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Summary and Conclusions

Our discussions about risk, control and how limits work in banks and insurers reveal a complex set of issues and raise more questions than we are able to answer in this study. It is clear that banks and insurers are different from one another, but different parts of each may be more similar and others more different in terms of finding a balance between risk-taking 'sandbox guardianship' and 'gold-plating' conservatism. Moreover, how risk culture is defined in risk appetite policies and practice is at the core of the issue, not least the extent to which policies on limits and or procedural controls have real traction over actual behavior. There is little doubt that the current public discourse about risk culture implicitly associates 'good' risk culture with risk conservatism (although debates in 2013 about bank lending to small business may be disturbing this view). Talk about risk culture becomes a code for giving more authority to risk management, as we saw in a previous section, so trends towards 'gold-plating' of rules and regulation may be understandable. This tendency is reinforced by collective and individual memories of highly deviant risk cultures in which CROs were simply yes men. Indeed, an important and variable dimension of risk culture is how organisations, including regulators, preserve the memory of bad practice. We saw above that one way this can be achieved is by the memory of individuals who worked in failed organisations, but this is largely accidental.

The setting of limits and boundaries via clear authorities for first line activity, and the monitoring of these limits, was a universal aspiration in all our organisations. This suggests that the problem of risk culture may be as much about recovering clarity and enforcement capacity over organisational activities as it is about changing mindsets. To repeat the observation made elsewhere in this report (in particular, see the practitioner literature review, Appendix C), we did not detect a cultural longing for a more solidaristic and communal organisation, in which risk sub-cultures are not tolerated, though such a uniform view of culture is something which we find is often implicit in some consulting templates for risk culture, as well as regulatory pronouncements of the topic.

Our view of trade-offs suggests that deviant risk management behaviour within organisations is not really about the level of risk-taking as such. If we take the example of NASA, where risk-taking is essential for space exploration, events like the Challenger shuttle disaster might be reasonably expected from time to time even if not at all desired. Indeed, they may be necessary for organisational learning. While the Challenger launch decision is famously cited as an example of 'organisational deviance' (Vaughan, 1995) it is also the case that space exploration is a risky experiment and 'flying with flaws' is accepted. Similarly, financial services limits and risk appetite 'levels' can be set anywhere that an organisation wishes and have been subject to significant regulatory scrutiny for some time now. Hence, the deviance that was apparent in many financial organisations prior to 2008 had more to do with lack of transparency about the net risks taken and their contagion effects in the event of crystallisation (Power, 2009).

Our neutralist view of risk culture suggests that it is this organisational transparency and understanding of operational limits and boundaries of risk-taking which is critical, not necessarily the actual nature of the limits. In principle the limits can be anywhere. For us a bad risk culture is not one characterised by high risk-taking as such but one in which this is not clear to all parties (both within and outside the organisation) so that informed capital, risk mitigation and regulatory decisions can be made. We shall return to this point in our conclusion.

There was universal emphasis on the importance of limits and tolerances and their enforcement and there can be little doubt that the actual operation of such limits, rather than policies as such, characterises the quality of risk culture at the firm level. Yet our research suggested a big difference between those risk management functions focused on what goes on inside the limits – the risk-taking within the 'sandbox' so to speak – and those focused on the enforcement of limits as such, with the risk of 'gold-plating'. The difference is a subtle but important one. The former orientation is more sensitive to risk-taking and value creation while the latter is more

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focused on compliance with limits as a system of rules. It is the difference between being sensitive to what is inside the limit and focusing on the limit itself. One takes risk management into a potentially productive relationship with the business, the other leads its work in the direction of rigid rule-compliance. The nature of risk culture hangs on this difference. So while it is true that risk appetite and risk culture are necessarily two sides of the same coin – namely, having legitimate and agreed limits which are enforced – attitudes to and perceptions of the meaning and nature of these limits by risk management vary in subtle but crucial ways along a continuum.

In terms of our distinction between organic and engineered approaches to risk culture change, we suggest that the so-called ‘sandbox guardians’ are more aligned to the former, while the ‘gold-plating’ champions are closer to the latter. Sandbox guardians leverage risk appetite to make risk-taking decisions part of business as usual activities; while gold-platers are likely to be heavily involved in ad hoc change initiatives that aim to implement and fine-tune new controls and processes. Interestingly, a conversation with senior risk managers in a large bank suggested a third approach that is even closer to our organic concept of risk culture. In this organisation, a more dynamic view of limits and boundaries around risk-taking emerged from the words of the interviewee (see Box 19). In short, drawing on the example of changes in the housing market, it seems that a sensible discussion on risk-taking is not only about the discretion within the set limits, but also about the discretion around the limits.

Box 19: Risk-taking and changing the limits

“If you look at the housing market at the moment there’s clearly a greater demand for buy-to-let mortgages than you might have expected because fewer people are able to afford deposits, more people are renting so there’s more demand for buy to let. Therefore given that change in the marketplace it’s right to look at your risk appetite where you’d severely constrained your buy-to-let within your overall mortgage portfolio. So it’s right to have that debate to look at the risks and decide okay can we move our risk appetite to allow more buy-to-let given the changes that have taken place out there? You lay down some constraints, you lay down some criteria. You have a sensible discussion and you reach an agreement that allows the business to grow and accommodate some of that demand for buy-to-let while still maintaining the overall risk appetite for the group.”

Finally, in all our discussions about risk-taking, limits and tolerances we heard very little about another key dimension of risk culture, the other limit of the bandwidth, namely, what some have called the ‘propensity for control’ (Anderson, 2011) This is as much a part of risk culture as risk appetite but receives far less attention. We gained a strong impression of concerns about too much control and a compliance culture (with blame often directed at the regulator), but these views were not supported by any intellectual framework other than general notions of ‘respect for control’ and a desire to avoid ‘gold-plating’. The propensity for control may also reflect a propensity of an organisation to develop knowledge about the risks it faces (see Box 20) but it is also hard to grasp for two reasons. First, it is inherently difficult to characterise the propensity for control in many operational areas. Second, in regulated industries it is not wholly under the control of the entity itself. In a number of operational areas, such as anti-money laundering, organisations have little choice but to invest what is necessary; degrees of control are not seen as part of a local ‘appetite’ but are a function of perceived regulatory expectation. We suggest that fixing and enforcing risk appetite across organisations does not necessarily impose a similar discipline over control investments.

Box 20: Lessons from safety risk

Stated zero tolerance for safety risk issues?

- This makes the airline’s internal discourse around limits very clear - no tolerance for risk.
- Such a zero tolerance is necessarily supported by an ambition to log every small safety relevant event via the safety management system.
- This means that investments in risk knowledge are also a matter of risk appetite; how much an organisation wants to know about risk also defines its risk culture

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Risk culture challenges for CROs, CEOs and Boards

- How do you get assurance that the risk function is focused primarily on supporting business decisions?
- Do you know which areas of the business are 'gold-plated' in terms of risk management and control? If not, how will you find this out and what will you do about it?
- When risk limits and tolerances are changed, is the risk function a leader or a follower in this decision?
- Do you understand the appetite for acquiring risk knowledge in your organisation?
- Have you ever discussed internally the implications for risk-taking and/or for your desired level of risk appetite in acquisition strategies, in particular if you plan to buy entire teams from other organisations?

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"I wonder if some of that is to do with the emphasis that certainly some of the consultancy firms I've come across will have focused very much on Solvency II related activity. And then we've seen as that's fallen away there's been a bit of a move back to a sort of much more wide ERM brief. But it ... means they took their eye off the ball vis-a-vis risk culture."

As we have noted elsewhere in this report, the increasing focus on risk culture since 2010 has created significant challenges within financial organisations as to how they can respond to pressures for change, pressures from their own Boards, from regulators and from the climate of debate created by each successive public report (see Chapter 1). An important dimension of this challenge is whether and how to take advice. Indeed, the use or non-use of advisors can be informative about an organisation's risk culture and the confidence of the risk function in its authority and capability to execute change (see Chapter 4).

In our investigations, we engaged with a number of consulting firms (both the Big 4 and non-accountancy firms) about risk culture and the related advisory platforms which they had or were trying to develop (primarily these were risk culture assessment tools). We also heard from many of the corporate actors about how and when they involved consultants in their risk culture thinking. Approaches within the organisations we visited varied considerably, from a preference to solving issues largely privately, to utilising and customising external risk culture survey instruments, to engaging consultants to advise on programmes of significant risk culture related structural change.

It was argued by some that risk culture change programmes must be developed and owned internally to be successful and that the role of outsider advisors was therefore limited. This chapter's opening quote is indicative of the degree of scepticism in some organisations about the ability of consultants to develop tools that address the specificities of risk culture. As exemplified in the quote, we met a number of individuals who saw consultants' products reproducing (or re-selling) more or less standardised compliance tools that have already been on the market for some time. Yet others saw risk culture advisory work as an indirect by-product of advice on business strategy and on the development of risk oversight structures, including enhancements to risk committees.

Overall, we found little consensus both about the use of consultants and their role and focus, but we did detect two broad clusters of opinion in play, which we label 'consulting sceptics' and 'consulting enthusiasts'. This is yet another form of trade-off which is at stake in the risk culture space and not surprisingly our distinction mirrors in part, but not perfectly, the difference between organic and engineered orientations to risk culture change. However, we also observed that some consultants were beginning to gravitate to advisory services of a more organic nature and this could be a topic for future investigation.

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Consulting sceptics

We conceptualise ‘consulting sceptics’ as those organisations which have tended to adopt a pragmatic and organic approach to risk culture change by seeking to leverage internal resources, especially in relation to the assessment of their cultures, rather than relying on consulting organisations to do this for them. On the positive side, these organisations perceive the benefits of a high degree of customisation (in relation to the design of risk culture surveys, for example), together with an opportunity to develop models from internal and existing data which can track and measure their risk culture in some way. For instance, in two large banks we were told about internal change programmes producing ‘red flags’ and ‘leading’ indicators that might show whether people treat risk management seriously. These metrics were becoming part of divisional and personal performance management systems. In both cases, the ambition is for simplicity in developing the right set of indicators.

An insurer, which had also conducted its own internal survey processes, noted that the internal debates were fun and enjoyable (“people love it”) but found that actionability was harder. Paraphrasing the CRO at this organisation, the struggle was *what to do with the results of the internal survey processes*. So for this organisation the point of risk culture metrics seems to be more to create internal conversations across different parts of the organisation, rather than to measure risk culture ‘performance’, something that is largely at odds with the audit- oriented approaches adopted by many consultants, at least to date.

Less positively, there was scepticism about the quality of advice (see Box 21). For example, INS_2 admitted that it was probably not an easy organisation to which advisory services could be sold. It perceived consultancy organisations as trying to resell Solvency II work as risk culture tools. As put by a senior risk manager participating in our survey follow-up meeting:

“So yes, the people I’ve had the conversation with and been discussing where we’ve been going in those areas started mentioning risk culture, yes. They had been a bit at a loss to offer things in that space. They’re trying to resell Solvency II related activity in a way.”

Box 21: CII survey

The CII survey indicated that those financial organisations tending to use consultants initially were motivated by regulatory concerns, but equally there was some suspicion amongst respondents of advisors merging Solvency II and risk culture work.

Consulting ‘sceptics’ can be partly defined as those risk management groups who perceive a high degree of benefit in being able to link risk change programmes with other organisational parts. Their view is that this internal networking work is the optimal way of ensuring that any change becomes business as usual because it is more likely to be owned. A key source of data, in the absence of adhoc risk culture surveys promoted by external parties, was HR-related work. As put by a senior risk manager we met in a large bank:

“We’ve had plenty of presentations on how you could do a risk culture survey from plenty of third parties but within the group we have a well-established employee survey that’s done on a full basis once a year and on a pulse basis in the intermediary six months. So you have a wealth of data already available from the employee survey.”

In so doing, consultants’ sceptics are often closer to what we called ‘partnership builders’ (Chapter 4) and touch point ‘enthusiasts’ (Chapter 5). In all three cases, the approach of this category of people is closer to an organic way to change or manage risk culture.

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It is important to note, however, the limitations of such an approach to change. Similar to the arguments about 'pragmatists' in Chapter 4, it requires more time for risk management to build its authority, while change initiatives can be fragile and tentative, supported by fewer resources. At one insurer, for instance, a change agent within risk management could only devote 10% of his time to risk culture. Furthermore, self-directed organic approaches to change offer fewer opportunities for external benchmarking and challenge, which consultants can provide.

Consulting enthusiasts

A number of our respondent organisations did use consultants. At BANK_4, a consulting organisation had initially helped them to develop a red flag process based on a diagnosis of key errors in the wake of the crisis. This diagnostic approach helped to reveal some key themes. Over time, this organisation has owned and run the risk culture change programme and reported in 2013 that it no longer uses the consultant for this work stream.

Another bank used the same consultant to conduct a large group-wide (cross country and business unit) risk culture survey. This consulting organisation was chosen for its reputation in the area and the fact that they have good access to benchmarking data. The survey was a customised version of a standardised offering and enabled drilling into pockets of the organisation. This was not a stand-alone risk culture product, but part of a broader business review commissioned by the Board. According to our respondents at this bank, there were not many surprises arising from the survey which in fact confirmed the prior view of the 'strength' of the risk culture. Indeed, the CRO noted (with some pride) that the consulting organisation had reported that their survey results were the 'strongest' seen in terms of alignment between risk function and business. The survey had produced evidence of a close correlation between the business and risk function in terms of their perception of risk and risk management. The survey results were widely distributed to a range of internal committees to help raise awareness around cultural issues and, in part, to tell a story of the bank's cultural 'success'.

A senior risk manager we met at the beginning of our investigation in an insurance company affirmed that a consulting firm had also been asked to look at their risk culture. The manager felt "actually quite pleased" about the results as the consultants argued that risk management was "very well embedded" in the business compared to peers. However, the advice had a strong regulatory footprint: the advisor had suggested that the company was not good at "writing it down" and moving from conversations to "having things in the minutes".

Indeed, in our survey of CII members it was clear that regulation figured strongly in decisions to use external advisors on risk culture, and those who chose advisors for this reason reported a high level of satisfaction with advice, we think because their expectations were limited to regulatory compliance. This result of our survey suggests that a compliance and regulatory based approach to risk culture may have been a necessary starting point in this space, although one which has less traction on behaviour than the more difficult arena of ethics and incentives, to be discussed in Chapter 7. It also suggests a tighter fit than is often assumed between regulatory interest in risk culture and advisory work in this space. Advisors have seen an opportunity to work partly or wholly as extensions of the regulatory process, not least, in the context of insurance, because of the significance of Solvency II risk management advisory work. However, our research also showed how this was changing over time. Advisors who had obtained a client foothold in risk culture work were keen to evolve beyond the regulatory starting point, even to the point of developing long term partnering relationships with financial organisations.

We should not assume an either/or approach to consulting scepticism or enthusiasm. Organisations using advisors were not always full enthusiasts and those who were sceptical also sometimes used advisors in order to get new projects and change initiatives moving. For example, BANK_4's use of an advisor initially helped to reinforce internal resources dedicated to risk culture and internal networking – thus obviating the further need of the advisor.

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In general, we suggest that when organisations are consulting enthusiasts, even if only temporarily, they seem more likely to adopt an engineered approach to risk culture change involving the internal leveraging of external models. In addition, they already have some confidence that their risk culture would 'score' well in any survey instrument. Bearing in mind these remarks, the use of external consultants is undoubtedly a key feature of an engineered approach to risk culture, reflecting ad hoc interventions where surveys and metrics are used by organisations who seek to 'do something' about risk culture.

Contingent factors: advisors and their struggles

A more or less enthusiast approach towards consulting services depends on a number of factors, including the perceived amount of regulatory pressure, confidence in the organisation's knowledge and expertise, the perceived knowledge and expertise of consulting firms, and the breadth of change programmes. We focus here on one particular contingent factor that relates to the supply side of the advisory market, and in particular the struggles that consulting firms face in the design of 'new' risk culture products. We suggest that part of the reason for a range of consulting enthusiasts and sceptics is due to the many different perceptions and understandings of the object itself, namely risk culture. And these differences translated into struggles for advisors themselves.

It is often said that consultants are quick to exploit market opportunities around new issues and debates. However, we observed that risk culture, as an advisory object, posed significant challenges for the advisors we met. Indeed, advisors faced many of the same problems as financial services firms in turning the general debate about risk culture, and observations about failure within the industry, into a clearly defined 'advisable object' that can be operationalised. There were obvious pioneers in thinking, like McKinsey who were early to develop a risk culture tool (Levy et al., 2010) in conjunction with their clients who were 'consulting enthusiasts'. This tool models the multidimensional nature of risk culture across a number of factors or pressure points. All of the other consulting products we came across adopt a broadly similar design approach, though the factors they choose often vary, depending on the perspective they adopt (see Appendix C).

As more advisors entered the risk culture market we saw a multiplicity of efforts involving very different forms of expertise (as highlighted in our practitioner literature review, see Appendix C). Culture and risk culture were often evoked in our discussions, but in the same breath admitted to be fuzzy and difficult. We sensed that advisors were confronted by two specific issues. First, what is the right expertise base of the advice platform? Second, can risk culture advice be sold independently from a range of other advice platforms?

At two meetings with representatives from two different consulting organisations we met human capital advisors and financial services specialists, including remuneration consultants. This provides evidence of how new cross-discipline advisory configurations are taking shape around the risk culture problem. We learned that a number of consulting organisations were employing psychologists and other non-accounting specialists, also suggesting a shift in the way that governance more broadly is being thought about, and the kinds of expertise being introduced, even within financial institutions. For example, we were informed that a major bank is hiring risk staff from the airline and oil industries. And, as we note below, in the case of risk culture, measurement of some kind remains hugely important but it is not the measurement traditionally associated with accounting and finance.

Despite the salience of the topic, a number of advisors admitted to struggling to present risk culture "as something that the market can buy". Not only was it a 'fluffy' issue but also standardised risk frameworks seemed to inhibit the advice process. We encountered considerable dissatisfaction with ERM models which were generally recognised as poor at capturing people risk aspects and were insufficiently company-specific. Yet the view was expressed that more company specific approaches adopted by some consultants may not work so well if the company's strategy changes.

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Staff at CONS_1 confessed that cultural work streams were difficult to sell as a stand-alone service and had to be linked to other services such as business planning or board KPI development. They were trying to combine culture and risk models, using HR simulations to put individuals under decision-making stress. Yet there was also unease about having too many cultural KRIs in the HR space. The key issue was to understand the “points of crystallisation” and “what can be used to generate action”. As we have noted elsewhere, there was widespread agreement that ‘how decisions are reached’ is critical. One interviewee suggested that while regulators are “exhausted with frameworks (and are) now focusing on risk culture”, they also need “something tangible” that can impact on behaviour. This is perhaps the essential tension and trade-off about metrics in the risk culture advice field (see Box 22).

Box 22: Safety metrics

Interviewees at AIRLINE commented that the desire to quantify can be problematic and sometimes misleading. The organisation found that where measures are requested by the regulator, then there can be spikes in reporting due to misclassification. As put by the manager, “context is crucial”; it is important to have time to sit back and reflect as much as to collect and analyse data.

In response to increasing numbers of customer enquiries, one advisor was in the process of developing an enhanced risk culture scorecard tool from an existing database of 200 questions. Another consulting firm did not advise on risk culture separately but provided advice in combination with ERM, intellectual capital and employee morale surveys. Rather than having a clear risk culture instrument, this firm sought to use and blend a mix of existing capabilities, such as HR or change management. At this firm which mixed risk, financial services, employee benefits and human capital expertise, there had initially been low interest in cultural advice. Yet, while demand was increasing, they felt that clients were also sceptical of consultants’ offerings and did not see it as a straightforward product. In our own research we found our focus groups more informative than the large scale surveys. Yet the focus groups were also productive because they were preceded by a short survey to stimulate discussion.

CONS_2 also saw survey work as providing a way to hear the voice of employees and, indirectly, customers since this was at the heart of risk culture and criticisms of banks (e.g. the Salz Review). Yet these surveys pose challenges of operationalisation, not least because of their frequency and competition for space in more generic staff mood surveys. Survey fatigue is something we heard from many parties in our research. For example, BANK_3 reported that they preferred to embed risk culture relevant questions in the annual employee survey rather than using a stand-alone instrument. There was broad recognition that while surveys lend themselves to quantitative data and the ability to track performance over time, they were less good at conveying how risk issues landed in the business and how risk is discussed in daily decision-making. Another consulting organisation has made explicit the need to focus on risk culture as revealed and made visible in behaviour which can be tracked, rather than focusing on corporate norms and statements. This consultant has developed the idea that cultural reinforcers and moments that matter need to be identified within organisations as a focus for attention, rather than culture in general. For example, such ‘moments that matter’ might be the key ‘challenge conversations’ and where they happen in the business.

Summary and conclusions

There is clearly a wide variety of ways in which our sample organisations have sought to engage with external consultants on the topic of risk culture. We suggest that organisations with a more organic approach to risk culture will tend to use consultants minimally, if at all. Organisations which have wide ranging change programmes for risk and risk management are more likely to use a consultant at some point in the process, perhaps because their perspective on risk culture has more in common with the approaches offered by consultants. Minimally this may involve addressing risk culture as a dimension of regulatory expectations, rather than any desire to support business decisions or to increase operational efficiency.

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Yet for all this variety in approach, the tracking and benchmarking of the visible aspects of risk culture is common across the board. All organisations, their consultants and regulators share a common ambition to make risk culture visible and actionable, and this necessarily involves shrinking it in some way down to a set of key factors and their related metrics, which capture the 'respect for internal control' or other 'moments that matter'. As boards are made more explicitly responsible for risk culture, then we can expect to see an expansion of these reductionist approaches which create an evidence base for risk culture and enable it to be monitored.

However whether this will help to improve the 'management' of risk culture, or render a low resolution and potentially misleading picture of the actual risk cultures of financial organisations remains to be seen.

Despite the apparent success of consultants' survey instruments, as judged by increasing demand for their use, these advisors have struggled to shape the risk culture agenda in any consensual fashion and, at the time of our research, have been engaged in developing practice, but not cementing it. Many consultants face an epistemic tension between their traditional knowledge base in internal audit, performance measurement and decision support, and the softer dimensions of risk culture. Furthermore, the risk culture space is amenable to many different kinds of expertise. For example, remuneration consulting by HR specialists is becoming steadily more behavioural in focus. It is significant that the potential for risk culture work has forced the creation of new internal alliances within consulting organisations, as they try to match a hybrid and messy object with hybrid intellectual resource. However, we saw no evidence of any willingness to engage with professional anthropologists, who might reasonably be regarded as experts on culture (e.g. Bonisch, 2012). Indeed, we sensed very little engagement with academics as risk culture advisors. This compares with our comparator airline (see Box 23)

All these struggles at the client interface have not inhibited a large number of client-facing events on risk culture and related topics, not least general topics on ethics and 'doing the right thing'. Such events, often attended by non-executive directors, provide an opportunity to distil the knowledge of practitioners and to build up new forms of practice inductively from the client encounter.

Finally, most advisors working on risk culture explicitly reported to us that they were highly dissatisfied with regulatory compliance as a starting point for thinking of risk culture, even if this has shaped early experiments by many companies. Their concerns suggest that there is a strong regulatory footprint on risk culture work streams which we address in the next chapter.

Box 23: Airline versus financial services

AIRLINE appears to have:

- More openness to the external world
- Much respect for external advisors, especially academic experts
- More use of, and engagement with, external research to validate and accredit their internal work

Risk culture challenges for CROs, CEOs and Boards

- Does your organisation essentially have respect for advisors? Are you open to advisory propositions? How often have you been contacted by advisors in relation to risk culture in the last three months? How often have you found their proposals novel or of any interest?
- Do you have processes to discuss the kind of expertise you may need, internally and externally, to progress risk culture change? Do you have an appetite for benchmarking with external entities? What have you done about it?
- Have you ever approached the topic of risk culture in meetings attended by people from both HR and Risk? If you are a member of Risk, do you have access to raw data from internal staff morale surveys? Or customer satisfaction surveys?
- Is your organisation open to exchanges with research organisations like universities? If not, are you sure of the reasons? If so, when was the last time there was such an exchange?

Chapter 8:

Regulatory Culture

"... I love that phrase, bureaucratisation, for risk management ... it just describes exactly what regulation is becoming [...] and that is one of the frustrating things that so much effort is put into producing things of limited worth."

This quote highlights the regulatory challenges that financial organisations can face when trying to demonstrate the effectiveness of less tangible risk management activities. The challenges could well increase given that regulatory organisations are taking considerable interest in the cultural dimensions of risk-taking and its mitigation. As noted in our background section (Chapter 1) and practitioner literature review (Appendix C), a number of official reports have highlighted 'failures' in risk culture. Speeches by senior regulators and related publications all point to a new regulatory focus on risk culture involving efforts to understand its more visible components (such as staff remuneration).

The challenges for regulators are similar to those of consultants discussed in the previous chapter, namely to encourage the design of credible interventions and tracking mechanisms for risk culture which can be evidenced for regulatory purposes. Yet it is unlikely that this regulatory attention to risk culture is neutral. Drawing from the existing academic research on the aims and effects of financial regulation (e.g. Danielsson, 2003; Barth et al, 2006; Laevan and Levine, 2009; Eling and Schmeiser, 2010) we have every reason to believe that the interests of regulators in improving risk culture will have both intended and unintended consequences. Indeed, our investigations suggest that financial regulation is itself a kind of cultural force which shapes the way that financial organisations respond to pressures to understand their risk cultures more explicitly (see Box 24). From this point of view, the challenge for regulators is to find ways to understand their own influence on how risk culture is operationalised in financial organisations, including their impact on risk appetite and their propensity to expand documentary traces which may give an 'illusion' of good risk culture.

Chapter 8: Regulatory Culture

Box 24: CII member survey

The analysis of our CII member survey results revealed a strong regulatory influence on risk culture work. Here regulatory requirements and expectations were found to be the strongest drivers for risk culture initiatives, as illustrated in the Table below (1=strongly disagree; 7= strongly agree):

The main drivers of the 'risk culture' change programmes were ...	Mean
1) Regulatory requirements	5.2
2) Critical events and/or near misses	4.5
3) Expectations of financial analysts	4.4
4) Expectations of shareholders	4.5
5) Losses and/or organisational crises	4.2
6) Expectations of regulators	5.2

The survey also highlighted that the benefits of risk culture work was perceived to be regulatory in origin (1=strongly disagree; 7= strongly agree)

The 'risk culture' change programmes ...	Mean
1) Generally received positive feedback from employees	4.6
2) Helped improve performance in my area of responsibility (eg fewer errors)	4.8
3) Helped to ensure that my area of responsibility is compliant with regulation	5.3
4) Improved the quality of my company's external disclosures	5.0

In addition, we found a link between respondents who emphasised the regulatory benefits of risk culture work and those who used consultants. This link suggests that those organisations whose risk culture is most influenced by regulators are also those that are more willing to use the tools and risk culture products offered by consultants. Hence it is likely that regulatory interest in insurers risk cultures is also encouraging them to become more 'engineered' in their approaches, for better or worse.

In relation to the cultural force of regulation, the trade-off for financial organisations is the extent to which they preserve their own local habits of risk management or whether their own risk culture is essentially an extension and mirror image of the regulator. We doubt that senior members of organisations are fully conscious of this trade-off and its actionable possibilities. There is more likely a situation of organisational drift (Alvesson, 2002) in which regulatory and organisational cultures become intermingled and indistinguishable; the issue is not even seen as a 'trade-off'. Although the phenomenon requires much more investigation, our investigations did reveal some variation across our sample organisations, suggesting how this invisible trade-off between regulator and regulated risk culture nevertheless has some visible traces. We identified two broad clusters which we label 'frustrated' and 'co-operative' approaches to regulation.

Chapter 8: Regulatory Culture

Frustrated

This cluster of financial organisations tended to adopt a more frictional attitude to regulation; we heard quite a bit of negative comment about the effects of regulation during much of our work. A large proportion of these complaints focused on the regulatory demand for evidence as a distraction from ‘real’ (i.e. value generating) business activities.

Documentation

Several interviewees noted that risk culture poses some unique problems of documentation in trying to make soft factors visible and measurable. Indeed, evidence and metrics are at the heart of the many trade-offs and tensions involved in making risk culture real for management and regulatory purposes. As we have already discussed (see Chapter 2 and Appendix C), risk culture may be tracked and measured in visible ways. But the very instruments which exist to do this e.g. staff surveys and other tools, provide only indirect observations of behaviour at best. Furthermore, the process of writing things down has its own effects; academic research suggests that behaviours can be ‘crowded out’ by the need to create audit trails (Power, 2013). In one organisation we heard that they were comfortable that the risk culture was good, but it was hard to demonstrate this, especially for areas of their business which tended to be highly ‘action-oriented’. The initial quote at the start of this section illustrates this problem.

Another CRO confirmed that the organisation was “not good at writing things down” but Solvency II is making “us write a lot more down than previously”. This organisation has a small risk team but felt that regulators come with preconceptions of what can or cannot be done. As put by the interviewee, interactions with the regulators are “changing the dynamic I think of what we would do ourselves naturally”. For example, according to the interviewee, this organisation had a small, good quality risk team that worked well for a relatively small organisation: “it’s relatively easy to turn the dial on things like performance metrics and the way we do business.” This may all change because of the regulatory pressure to do things in a certain way.

At INS_1, it was argued that Solvency II documentation requirements were substantively affecting underwriting decisions, i.e. making underwriters more risk-averse. One interviewee (already quoted in our interim report) put it rather bluntly:

“It’s bureaucracy gone mad and is destroying the culture we have. The pressure on individuals is phenomenal and has a negative impact on morale. They don’t blame the company but just looking at what was being asked of them it was very clear it has limited real value to us or the regulator.”

The same person went on to suggest that while the company was able to explain why it does what it does, it was also being asked to explain why it does not do other things, a requirement which necessarily expands documentation significantly. Solvency II was particularly criticised, not only because of its perceived damage to competitiveness but also its impact on insurance work. We heard that the company has lost employees to roles where they have been guaranteed no Solvency II work. The company was also particularly concerned about bureaucratisation and had counted the number of sheets of paper sent to regulators. In meetings with the regulator, they felt that a KPI was needed in order to be satisfied that something is how people say it is. However, they also perceived the regulators as being under pressure to deliver ‘results’, especially in the light of the financial crisis.

Interviewees at INS_3 also commented on the paradox of increased formalisation created by regulation. They were aware of organisations that became much better at documenting, but did not improve their underlying ‘culture’. They reported that regulators are less interested in the substance and more in what is written down. The CRO noted that the need for good ‘secretarial skills’ is increasing as the pressure to have strong minutes in governance sensitive committees rises. The essential problem with regulators was reported as one of balance. Too much effort goes into writing things down and less into the substance of what has been done. Writing things down is not necessarily bad and may help to preserve organisational memory. However, in a context of increased regulatory pressure, there is a clear trade-off between writing minutes for regulatory purposes only and writing things down to make sure that organisational actors debate what they think they should debate.

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Several consultants were also sceptical about the effectiveness of regulatory intervention. Staff at CONS_2 observed that insurers had become more prudent and the CRO was now stronger. This consultant runs an ERM survey within insurers each year and noted how the risk culture element is becoming more prominent, with insurers feeling the need to demonstrate action in this area. Yet they observed that risk culture work remains a struggle and that risk appetite statements fall between being a kind of 'vision statement' produced primarily for regulators and a detailed description of the business as it is. We sensed that some organisations may have lost confidence in how to frame 'policy' documents as they perceive the regulatory environment to be more adversarial.

Another consultant spoke of their experience with their clients. A tacit risk culture can be good but it is impossible to assess how robust this is. One organisation may have a 'worse' risk culture than another but is better able to document what they are doing, thus appearing 'stronger'. They raised the question of what exactly the purpose of documenting the components of risk culture might be. On the one hand it may be good for organisational memory, but the issue is to understand how such measures would actually be used. Who is leading the production of documentation? Is it led by the risk department? Where is risk information owned? How can it be used?

Our discussion suggests that the process by which documentation about risk management is produced may itself say more about the risk culture of an organisation than the documents as such. For this reason we draw no firm conclusions about documentation. Evidentiary processes can be a signal of a determination to challenge and understand risks in the business. In short, they can make for a more empirically informed risk culture when the motive for documentation is internal and clearly understood. Equally, documentation demands experienced as imposed for external verification purposes are seen as an extension of regulatory compliance.

Risk aversion and 'opportunity crowding'

Managers at INS_2 spoke of their relationship with the regulator as driving a cautious mindset, involving the documentation and checking of everything. Paraphrasing a participant in the survey follow-up meeting, *if you do something different you're an outlier and that draws the attention*. The Solvency II programme is intense and the regulator keeps coming back to prove that particular methodologies and models are appropriate. Compelling evidence is what the regulators constantly look for. We heard that other parts of the group refer to this as the 'English disease', namely the need to write everything down in terms of processes and evidence. While it was admitted that this has a positive dimension in terms of the quality of business cases submitted, there is less ability to take opportunities.

At a survey follow-up meeting, it was commented that the volume of regulatory change is unprecedented. In addition, central risk and compliance projects can also put pressure on the local team – central deadlines can be very demanding and at times they can be swamped with group initiatives (although they did not seem angry about this – more resigned). We sensed that there was a perceived 'crowding out' of local value creation where time spent on compliance creates an opportunity cost by limiting the time available for actual risk management and more creative thinking in conjunction with the business. The CEO was especially concerned about the findings from our survey that suggested a compliance-dominated focus within risk management.

We also heard that a few years ago (prior to the financial crisis) regulators were pressuring insurance companies to manage risk more like the banks, for example by using risk capital models. They were told by the Financial Services Authority that they should look at, and learn from, risk management in the banking sector. The suggestion was that there were good models there, and that insurers could learn from banks about the measurement of tangible effects. The result was a perceived loss of focus on the softer aspects of risk management, which are now returning to view under the label of risk culture. It was noted with some amusement that the modelling approaches adopted by the banks had not really helped them manage the effects of the financial crisis.

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Finally, a large global bank was critical of the regulator for being too focused on the old CRO/CEO model and too sceptical of their new ‘three and a half lines of defense’ even though the Board finds it very attractive. At a second meeting we learned that the regulator was still unsure about their desire to split the risk function between first and second line functions. The original intention was that these functions would have separate risk reporting lines, but the lead supervisor vetoed this. In effect, a regulatory risk culture based on the TLD model finds it hard to digest any deviation from, and innovation to, this model.

Overall, our group of ‘frustrated’ organisations were largely but not exclusively insurers, and we noted that they were more likely to be aligned with an organic approach to risk culture change involving longer times scales and working with existing internal resources. They tended to be fearful to varying degrees that the external influence of regulators would damage their internal approaches to risk management and risk-taking.

Co-operative

In contrast to the ‘frustrated’ cluster, we also found organisations – mainly banks – that were far more accepting of the regulatory mandate. For example, the CRO in a large bank suggested that they had an ambition to align with regulators’ expectations. The financial regulator was a given and if one didn’t like it, then one should go to work in a different industry sector. So their philosophy is that developing resistance is unlikely to be a fruitful strategy and thus a waste of resources, though the CRO emphasised that the business still needs to fully recognise that compliance with regulatory requirements has a cost in terms of time and resources. ‘Conduct’ risks are a ‘pain’ (in recognition of increased regulatory attention from the new Financial Conduct Authority), but it was argued that they need to be thought of as an opportunity also. Furthermore, it was commented that the business must recognise that conduct risks will have a hit on profits if they are not managed properly.

At the survey follow-up meeting at BANK_1, the attendees accepted that the business has had to cope with increasing regulatory pressure, especially at a senior level (they try to leave traders/risk-takers free to do their job). As an example, the local risk team now have a specialist group which responds to regulatory requests, when only a few years ago this work was simply absorbed by the business. This change and its associated costs have become business as usual and are simply accepted.

Interestingly, it was also reported that regulation had enabled some groups to argue for specific investments in technology, so that there are some internal winners from regulation. This organisation, like others, also highlighted tensions with regulators regarding its TLD approach. The regulator had expressed concerns about the closeness of the second line risk function with first line business operations. So being ‘co-operative’ is not without tensions and there was also scepticism about the very possibility of measuring and reporting on risk culture. One participant to the workshop exclaimed that it was ‘insane’ that they had to be scored on certain dimensions. Overall, the ‘co-operative’ set of organisations tended to have much less concern about where regulatory culture ends and their own risk culture began. Indeed, at the extreme they are indistinguishable. An interesting contrast is provided by AIRLINE (see Box 25) which appears to be co-operative to the extent of having an explicit partnership with the regulator, including shared technology.

Box 25: Regulators and Trust

- CAA officials are respected as ex-industry people and former pilots.
- A symbol of this positive relationship was that the CAA was given direct access to screenshots from internal safety reporting systems. This arrangement clearly requires a high degree of trust but it also fosters industry awareness and learning about incidents.
- The airline example illustrates how technology can in principle be used to support a partnership with the regulator, providing a platform for more meaningful interaction.

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Contingent factors

Regulatory pressures can be seen as a macro contingent factor affecting a number, if not all, of our trade-offs. Our sample of banks and insurers is small but the data suggests that insurers and banks differ in their acceptance of, and attitude to, regulatory intervention. We heard many insurers, particularly the smaller ones, expressing frustration that they were being regulated like banks. In contrast, the banks seemed to accept that recent experience in the industry had given the regulator a mandate to intervene. Indeed, our results must be placed in the context of the aftermath of a banking crisis in which regulatory authority has increased. Overall, we found that the 'co-operative' group tended to model their risk culture change programmes according to regulator needs. While there was still some frustration expressed, there seemed to be more pragmatic acceptance of the regulatory influence.

Our observations remain tentative and subject to a number of further qualifications. Much depends on size and the capacity to absorb regulatory costs. There may also be a distinctive 'UK effect' in terms of a jurisdiction which has been hit harder than many others by the crisis in banking. The culture of risk management in UK banks has little choice but to work very closely with regulators. Relatedly, organisational attitudes to regulation may be shaped by specific historical experiences of crisis.

Reactions to regulatory pressures also depend on internal structural organisational arrangements and cultural predispositions. At INS_1 we observed that junior staff members 'suffer' less from increases in compliance checks and policies – the burden is largely borne by senior people. As put by one interviewee, junior people in this organisation are to be 'protected', while, in the context of increased regulatory pressure, "it's getting tougher on the more senior people." In contrast, INS_2 deliberately chose to avoid having senior management buffering regulatory pressure for more junior people. As put by one interviewee:

"We've deliberately prevented senior management from being that buffer because we wanted everybody right through the organisation not just to know what they were doing but why they were meant to be doing it."

We found this contrast particularly relevant from an organisational culture point of view. It shows how presumed 'external' pressures, and the conflicts that may arise as a consequence of them, are indeed dependent on internal organisational arrangements, values and norms related to the ways in which an organisation copes with such pressures. Therefore, prescriptively we can hypothesise that an important dimension of risk culture is how and whether regulatory demands are buffered from operations, and which personnel absorb increased regulatory activity.

Summary and Conclusions

We do not regard regulator unpopularity as being in itself indicative of regulatory failure of any kind. Indeed, regulatory theory suggests that such unpopularity is a necessary feature of escalated regulatory activity. So we draw no conclusions from unpopularity per-se. However, we think the nature and source of that apparent unpopularity deserves more attention than we have been able to give it in our work so far. Our research to date provides suggestive evidence that one of the biggest factors influencing risk culture in organisations is regulation itself. By this we do not only mean that the regulator has become explicitly interested in culture as the foundation of safe and consumer-facing financial services. We highlighted this in Chapter 1 already. Rather it appears to us that the existing regulatory footprint is often so significant that it can be difficult to determine where regulation ends and internal policy begins. In short, risk culture is already highly institutionalised. Regulation pervades financial organisations and is already a feature of their risk culture – hence our categories of the 'frustrated' and 'co-operative'.

Chapter 8: Regulatory Culture

It is perfectly reasonable that external regulatory organisations require a way to observe the actions of regulated entities. For example, financial returns are an important window on solvency and liquidity. Yet as documentary demands increase they generate a ‘writing-down’ orientation which is not simply neutral in its effects. Our interviews and survey work suggest that these documentary demands expand a compliance-style and engineered approach to the culture of risk management and favour those aspects of risk culture which are easier to evidence (but not necessarily more meaningful) than others. This in turn may lead to more risk conservatism in organisations and more standardised approaches to risk culture (e.g. the TLD approach to governance).

However, we should be careful not to associate documentation growth with risk conservatism too simplistically. Banks in the mid-1990s were subject to strenuous documentation processes in many parts of their business, but this did not prevent reckless risk-taking in some places. We conclude that the main effects of regulatory demands for evidence may be distraction and ‘crowding’ in terms of what the risk function spends time on. One sign of crowding is a potential disconnect between documentation and action, or what one CRO has called “management by observation”. Another would be the experience of having less space for discretion and judgment, and how this is distributed across risk management and business functions. This effect of regulation, including documentation, on trust in local managerial judgment and discretion is only suggested by our research and would be an important topic for future research.

Finally, a number of our themes in this report point in the direction of a pervasive regulatory culture in financial services. This is best understood as a ‘mindset’ and value system which is shared by organisational actors within regulators, companies and consultants (including external auditors), and is reproduced by the movement of people and careers across all three organisational boundaries. Regulators are part of this ‘regulatory space’ but are not its sole inhabitants. We have observed some other actors who would not consider themselves to be ‘regulators’ are nevertheless part of a powerful but invisible community which reinforces key elements of this regulatory culture.

In essence, based on our findings, we hypothesise that a number of risk managers in financial organisations, supervisors in regulatory bodies and advisors in consulting firms essentially share a view about what good risk culture looks like, and derive authority and resources from each other. For example, we heard at one bank that regulation has strengthened the hand of risk people; “the regulators have provided the tools we always wanted.” And although all the specific consultants that we have met have been very thoughtful and reflective about emerging risk culture advice, elsewhere in their own advisory organisations frequent assignments are undertaken on behalf of regulators under section 166 of the Financial Services and Market Act (‘skilled persons’ report on a firm addressing an area of regulatory interest or concern). Of necessity this skilled persons’ work tends to reinforce this regulatory culture.

Figure 5 synthesises these preliminary reflections on what we can call a ‘trans-organisational’ regulatory culture. The letters stand for individuals. A, B and C who work for financial organisations, regulators and advisors respectively, are likely to have more working habits in common than with others in their own organisations (P, Q, R). A, B and C are often interchangeable, and move between corporate organisations, regulators and advisory firms. The ‘inner circle’ characterises a less visible ‘shadow organisation’ or space, in which the regulatory culture described in this chapter is reproduced. Individuals within this space share values of due process, audit trails and compliance, and speak a similar language. Within this shadow organisation, we suggest that:

- A increasingly treats B as a client, while C is an agent of B
- B is dependent on both A and C, suggesting elements of ‘regulatory capture’, but equally our research suggests extensive influence of B on A and C. This results in a dynamic self-reproducing ‘regulatory culture’

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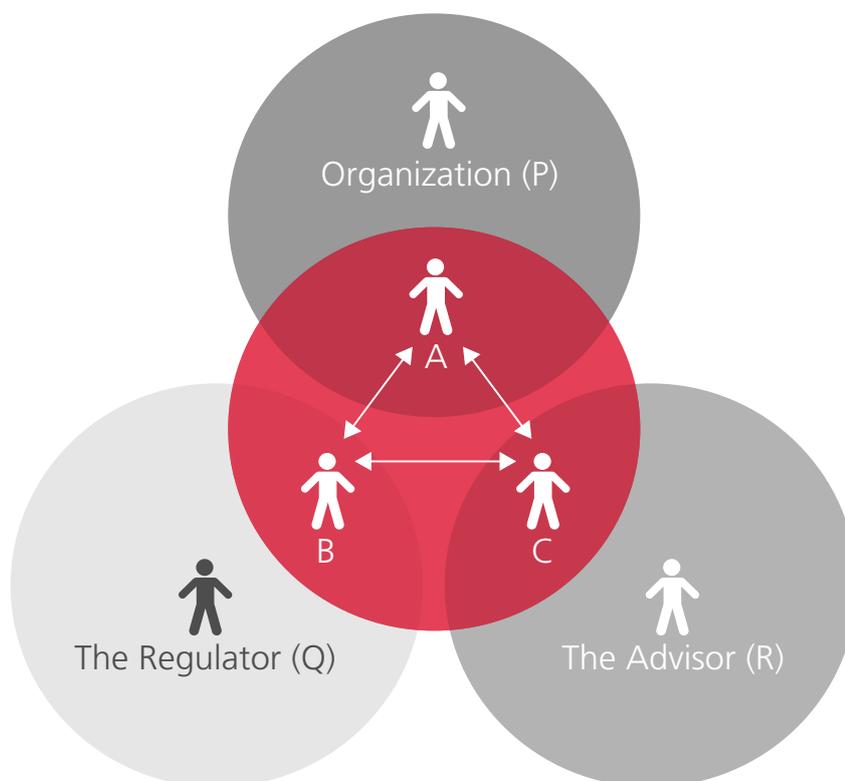


Figure 5: Trans-organisational Regulatory Culture

In conclusion, while our ideas are very underdeveloped, we think that this self-reinforcing network is poorly understood yet is responsible in part for the durability of what one of our respondents call the ‘English disease’, namely the idea that unless something is written down it did not happen. It also suggests that, for all the complaining about regulators, there is a much wider industry of regulatory agents that cuts across organisational boundaries. It is this trans-organisational regulatory culture, which we have only glimpsed in this research but which we are convinced exists and is a more powerful force than any organisation-specific manifestation of it, or indeed any specific financial regulator. This will be a subject for future research.

Risk culture challenges for CROs, CEOs and Boards

- Does your organisation genuinely respect the public objectives of the regulatory function? Do you have positive ‘regulation conversations’ internally? How often? Who is participating in such conversation (e.g. business, risk, compliance; senior or junior members of staff)?
- Do you push back and challenge the regulator? If not, do you know why not?
- If you think regulatory demands for documentary evidence are excessive, do you have a clear conception of what you would require in the absence of regulation?
- Do you have ways of tracking the extent to which regulation is ‘inside’ your organisation? Do you have any processes to track the impact of regulation on work habits and internal attitudes to risk? Would you like to know?
- Do you know how compliance experts are regarded in your organisation? If so, do you want to change that? If not, do you want to know?

Chapter 9:

Between Ethics and Incentives

“Too many bankers, especially at the most senior levels, have operated in an environment with insufficient personal responsibility. Top bankers dodged accountability for failings on their watch by claiming ignorance or hiding behind collective decision-making. They then faced little realistic prospect of financial penalties or more serious sanctions commensurate with the severity of the failures with which they were associated. Individual incentives have not been consistent with high collective standards, often the opposite [...] Remuneration has incentivised misconduct and excessive risk-taking, reinforcing a culture where poor standards were often considered normal. Many bank staff have been paid too much for doing the wrong things, with bonuses awarded and paid before the long-term consequences become apparent. The potential rewards for fleeting short-term success have sometimes been huge, but the penalties for failure, often manifest only later, have been much smaller or negligible. Despite recent reforms, many of these problems persist.” (Parliamentary Commission on Banking Standards, 2013b: 8-9)

A prominent feature of the post-crisis commentary and analysis has been the call for a new ethic in financial services, broadly encapsulated in a recent speech by Justin Welby, the Archbishop of Canterbury. He urged bankers to be ‘essentially’ good (Welby, 2013) and in the spirit of the Good Samaritan asked them to remember their neighbours, whether this be fulfilling the needs of their customers or society at large. In addition, more ‘earthly’ organisations, such as the CBI, CII and Which?, have also emphasised the importance of ethics in financial services, as evidenced by their testimony to the Parliamentary Commission on Banking Standards (2013c).

Equally prominent has been a focus on remuneration and incentives throughout financial organisations as another lever on behaviour, a theme that is especially popular with politicians and regulators (see our practitioner literature review, Appendix C). There have already been general reforms in remuneration reporting and disclosure, and pressure for a shift to long term incentives. Specifically, both the Financial Stability Board and the Basel Committee have been active on the issue of remuneration (e.g. Basel Committee, 2010), and much has been done at the European level to ‘reform’ incentive arrangements; as a result many regulators, including those in the UK (FSA, 2010, 2012) expect financial organisations to manage ‘incentives risk’ much more explicitly, and remuneration arrangements in general can be subject to comprehensive supervisory reviews.

These two strands of the public debate – ethics and incentives – represent opposite ends of a continuum in which financial organisations must manage trade-offs in their approach to behavioural change. On the one hand, the post crisis emphasis on the need to be ‘good’ as opposed to ‘greedy’ demands that people within financial organisations must change their fundamental orientation and rediscover a mission for service. On the other hand, we observe a focus on re-designing performance metrics to drive appropriate behaviours. Changing people’s motives is not the point. Can these two approaches – ‘ethical’ and ‘disciplinary’ - to behavioural change coexist? And at which organisational level may they be most effectively applied?

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Ethical approaches to behavioural change

We sensed that ethics and culture can be code words for a tight sense of organisational identity. For example, we learned of a strong sense of community in the people working for INS_3 reflected in very low staff turnover:

“And all these people that went to [the same] University and now they work there [at the Group Head Office] and they’ve always worked there and their parents work there, their uncles work there, their aunts work there, you know. There’s a supermarket, there’s a business school ... Hairdressing, dentistry, I mean the whole lot, it’s just one community, it really is.”

More commonly, the discourse of cultural reform in organisations has involved the renewal and re-articulation of mission statements to emphasise a focus on clients. The risk dimension of this involved efforts to validate what is called a ‘speak up’ culture where every employee has an opportunity to raise concerns. One insurer claimed to have a “no-blame culture” (reinforced through meetings and senior management talks) with clear support from the CEO, meaning that it was ‘safe’ to make mistakes.

We also came across the phrase “respect for internal control” here and in a number of different places (see Box 26), suggesting the influence of a specific advisor, who may have adapted this from Weick (see Levy et al., 2010). ‘Respect’, usually a concept involving relations between people, has been unusually extended to the relationships between people and systems. Indeed, respect for control implies that the system should be thought of as a kind of organisational person itself, as being a critical part of the organisational personality. At the survey follow-up meetings at INS_2 there were the following comments:

Box 26: *Just culture and respect*

At our comparator airline, we heard the phrase ‘just culture’ used to mean that individuals would be treated fairly, but that this did not mean it was a no-blame environment. Staff should feel safe to report adverse events and near misses. But they also must be clear about acceptable and unacceptable behavior. At a large industrial company we visited the new mission statement referred to ideas of courage and respect.

“With respect, respect is an interesting word in there because for me respect is a very different word to compliance [...] I think people who respected a system of internal control would challenge it [...] It’s more adult.”

While it is perhaps easy to dismiss the many efforts at renewing corporate internal narratives as mere sloganising, we did encounter a seriousness of will in making them actionable in some way, for example in training programmes. From this point of view, we think that the voice and authority of risk has been the channel through which abstract narratives of doing the right thing land in the wider organisation. In essence, risk is the vehicle for ethics. They are not two different things.

From this point of view, risk training can be viewed as an enculturation vehicle to promote the ethics of risk control, as well as being technical in nature. For example, at BANK_3 the CRO felt that risk training had tended to be dominated by technical regulatory issues in the UK, rather than the communication of corporate narratives (for example to reinforce corporate values), but they commented that this was changing. They had developed a “risk academy” involving risk training for non-risk people. At another bank, training was supported by the slogan “risk is me”. A large insurer was also focused on making risk more prominent in training and internal communications. There was a big focus on communication about Solvency II and what it means to people in practice, and this was supported by a “risk in action” website. According to our interviewee this section of the website has attracted the most hits of any portion of their internal site. This organisation won an award for communication expertise in relation to its “risk in action” work, even though there had been a mixed internal response, due to the perceived child-like nature of the approach, which included linking the organisation’s risk appetite to different foods. Some

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people “loved it”, while others found it “puerile”. But, paraphrasing the interviewee, the key point was that risk managers were interested *in ways of animating the risk conversation in the organisation*.

So it would seem that it was the debate that mattered to the organisation, rather than the technical content of the training. Despite the mixed response, the risk director was satisfied, because this debate helped to raise awareness of important risk issues, such as risk appetite.

Disciplinary approaches to culture change

In contrast to efforts to promote some kind of ethical renewal, through mission statements and training, we also observed in some organisations a strong emphasis on effecting behavioural change via new performance metrics and associated incentives.

Indeed, there was some blending of approaches in so far as we observed that one organisation monitored how many people attended risk training sessions and began to use this as a behavioural-level indicator for risk culture. But equally, the organisation was also trying to see whether training sessions were achieving their technical objectives by assessing whether people left with the right ‘toolkit’.

Remuneration structures are widely regarded as being at the heart of the culture debate but the picture at a number of insurers was complex. For example, at INS_1 the CRO stated that the bonus culture was modest. It was noted that if the group as a whole doesn’t make money, then people do not get anything more than small budgeted bonuses. This philosophy had created some pushback from the higher earners. The CRO acknowledged that the bonus culture in other organisations was different but noted that few people have ever left INS_1 for higher gains. Over the years, the organisation has tended to have “quite a bit of loyalty” though as the company grew, staff turnover had increased slightly. But we also heard from another CRO that staff turnover can be too low: at 2% per annum they couldn’t get new blood and ideas into the organisation.

This reveals another trade-off in thinking about risk culture which underlies the ethics-incentives approach to behaviour change. Very low staff turnover rates may positively reflect a strong sense of belonging in an organisation on the one hand, but equally the organisation can be all-encompassing. Dissent and challenge are not suppressed explicitly but are overridden by strong group values. History also has many examples of strong groups doing bad things, a factor picked up in the Parliamentary Commission report on HBOS (Parliamentary Commission on Banking Standards, 2013a). For this reason we are cautious about the enthusiasm of some commentators on the financial crisis for a renewed sense of corporate community.

On the other side, high staff turnover can point to a workforce that is constantly restless and seeking to optimise personal gain. From this point of view, incentive risk does not simply reside in the clauses of formal employment contracts but in the climate in which those contracts operate. Put differently, it is impossible to read likely behaviour simply from such contracts, even allowing for the risks of short-term performance targets. For example, we heard that the long term view is not simply a matter for the remuneration contract; it was difficult to have formal incentive plans for longer than 5 years, even if a longer time horizon was desirable. The latter requires softer (e.g. social) mechanisms of aligning people with the long-term mission of the organisation.

The overall organisational context of remuneration also matters. In many industry sectors high quality workers are attracted despite the modest levels of pay and often the absence of performance related pay and bonuses (e.g. nursing and teaching, although this is changing). This is a salient point even for financial institutions where the relative modesty of remuneration and bonus arrangements is offset by the use of other less pecuniary values. We observed this at a regional building society, where part of the ‘reward’ for working there was a less pressured and more family-oriented working environment. Another CRO, whose heritage was similar, reported that the remuneration structure in the investment business has been stretched only a little bit. People know and accept that they are not going to get big bonuses as there are clear caps in place.

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In terms of performance management within INS_2, metrics relating to Solvency II had been introduced in 2012 on an experimental basis. However, the overriding impression from talking to insurers was that individual employees had generally self-selected into organisations where they knew that they would not be making large bonuses.

In the banks within our sample, we saw more attention to building risk-related performance criteria into reward systems. This distinction between banks and insurers again highlights a potential relationship between ethics and remuneration. It may well be that high remuneration and bonus arrangements attract people with a different baseline ethical perspective, or even that these arrangements provide a reinforcing mechanism for more self-centred behaviours. This issue is highlighted in Appendix B of the Salz Review of Barclays, where it is noted that:

“There is a body of evidence which shows that extrinsic rewards, like bonus payments or contingent pay, dulls creativity, narrows focus and slows our capability to solve problems. Deci’s famous ‘Soma Cube Experiment’ required groups of people to work together to complete complex puzzles, some for reward others not. Deci played with multiple configurations of reward and multiple configurations of group. In each, the result is the same. The rewarded group consistently produced fewer solutions, were less engaged in the task, and were less socially engaged with their colleagues. The results are completely counter-intuitive. The conclusion is that when people are motivated intrinsically, they perform better and more consistently than when motivated extrinsically.” (Salz, 2013:191)

In our investigation we also found that metric-driven behavioural change initiatives may have unintended, though potentially positive, consequences for the level of interaction between the risk function and other parts of the business. In BANK_4, a risk culture change initiative started with a ‘stick’ approach that evaluated, on a quarterly basis, the performance of front-office managers (starting with a single business unit) against a set of risk culture metrics. Not meeting expected targets could have serious consequences in terms of compensation and career advancements. A year later, in our second meeting in this organisation, we were told that this metric driven change initiative had been extended to other business units. Interestingly, the person dedicated full time to this project recognised how the risk culture change initiative had enabled her to get closer to a number of other important strategic level projects, which were not explicitly related to risk culture change. Similar to our findings in Chapter 5 on interaction, risk culture change programmes – no matter what their initial focus and intended outcomes – seem to open ‘new doors’ and to increase the interaction of risk staff with front-office personnel and other teams of risk specialists.

Contingent factors

We do not ourselves have any direct evidence to support the observation in the Salz review that intrinsic motivations generate superior performance over extrinsic motivations like bonuses. However what evidence we do have suggests that incentives are complex across different financial organisations and that, while remuneration and tight performance management are undoubtedly important levers of behavioural change, they are unlikely to be sufficient on their own. For example, we strongly suggest that there is considerable variation in how the trade-off between harder and softer approaches to incentives might be managed across organisational levels and across divisions.

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Behavioural change through metrics may be more relevant (and feasible) at lower organisational levels. As put by one of our interviewees, metric-driven change is fundamental with the “boys and girls that sit on the counter in a branch.” Behavioural change is assumed to be more value-driven at higher organisational levels. For example, despite the great public and regulatory focus, senior executive remuneration schemes may be blunt instruments of behavioural change where issues of network reputation, and organisational mission figure strongly as motivators. Equally, for reasons of career self-selection, specific trading desks with mobile trading personnel may be entirely immune to ethical nudging and far more responsive to naked incentivising. Accordingly, there are many contingent factors at stake and it is no surprise that organisations have been experimenting with a mix of approaches with different emphases towards ethics and incentives respectively.

Summary and Conclusions

We have identified two discourses of reform in financial services that are rather different even though we find them inter-mingled in many organisations. As ideal types we label them ‘ethical’ and ‘disciplinary’ approaches to behaviour modification. The former assumes that individuals can internalise a sense of mission and collective responsibility. The latter deeply believes that individuals are naked optimisers of their personal short-term financial return, unless controlled via an enforceable contract. The CRO at one bank in our sample articulated our ideal types in terms of two complementary formulas to ‘strong risk culture’ (see Box 27).

The CRO went on to note that the two approaches, and their respective work streams, have different timescales, suggesting another kind of trade-off facing risk culture change programmes – the quick fix versus enduring change. The disciplinary, incentives-based approach can be achieved relatively quickly while ethical transformation is a slower change process consistent with much of the organisational culture literature that we reviewed (see Chapter 2). The CRO emphasised that you cannot train culture but leaders can ‘push it down’. In terms of our framework of analysis outlined in Chapter 3, the former is part of an engineered approach to risk culture change; the latter reflects what we call a more organic approach.

In conclusion, we note that it may surprise readers of this report that ethics and incentives are not a more prominent part of our findings. This is especially the case given that the restoration of public trust in financial services, along with the issue of remuneration, have been prominent themes in public discourses about the future of financial services (see Chapter 1). Yet many of the themes considered in other chapters – centralisation, authority, interaction, risk-taking, advice and regulation were far more evident in our open-ended discussions. In conclusion we suggest that there may be some interesting reasons for this apparent gap between the external and internal debates.

Box 27:

Two approaches to behavioural change

- 1.** Long term organic change: Tone from the top or a focus on ethics. Such an approach emphasises the renewal of values in the organisation, in particular an ethos of client service.
- 2.** Short term engineered change: A zero tolerance approach to compliance and other limit breaches with consequences for bonus, progression etc. Such an approach brings more and more imposed risk discipline and can be associated with an intense regulatory environment

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First, issues of both ethics and incentives have become compressed into, and operationalised by, the risk management agenda. Paying attention to the culture of risk-taking and control is the way in which these issues are translated into organisation practice. 'Respect for control' is an example of this translation. Indeed, such translation is arguably necessary because notions of 'doing the right thing' are otherwise simply abstractions. This process by which risk management is ethicised is not about making, for example, bank employees into 'good' people in some general and fundamental sense of that concept. It is rather about energising and authorising capacities to challenge and escalate, to build risk naturally into decision-making processes, and to welcome the risk manager as a colleague. This is really a matter of changes in specific institutional norms; 'doing the right thing' has little organisational traction unless it is made operational by such norms.

Second, other than in specific parts and levels of organisations, senior risk management personnel don't believe that formal incentive structures provide much by way of general leverage over what regulators now call 'behavioural risk'. From this point of view much of the external remuneration debate has been animated by levels of pay and bonuses, but simplifies, for political effect no doubt, the complex motivations of many actors in financial services firms.

Third, the CROs and risk managers with whom we interacted were necessarily very pragmatic and operated with an eclectic range of practices to define risk culture, seeking to influence and facilitate better practices, using metrics to initiate conversations, and expanding their footprint in their own organisations. Ethical statements or incentives risk analysis, though prominent externally, were in fact a small part of their internal change programmes. In sum, while financial organisations consciously and unconsciously managed a trade-off between two different kinds of approach to bringing about behavioural change, evidence from the other chapters suggests that this was itself part of a much richer way of thinking about how to operationalise changes in risk culture.

Risk culture challenges for CROs, CEOs and Boards

- Do you understand where in the organisation behavioural change is most necessary?
If not, how will you get it?
- Which combination of levers is most likely to be effective in bringing about that change? Is such a combination different in different parts of the organisation (e.g. functional areas or hierarchical levels)?
- How are you monitoring and measuring 'respect' for internal control and risk management?

Chapter 10:

Conclusions

Our investigations show that many organisations are taking issues of risk culture very seriously and are engaged in a variety of change programmes. Yet words like ‘culture’ and ‘risk culture’ are very deceptive. They are proxies for many different things. Rather than ask ‘what is risk culture?’ it is better to ask about the diverse range of things – instincts, attitudes, habits and behaviours – that make it up, what influences these things and how, if at all, they can be managed and reported on.

In our research, we have taken this line of questioning in reverse order. In essence, we have started with how the meaning of risk culture is revealed in the work programmes of financial organisations. Instead of answering the question ‘what is risk culture?’ directly, we have tried to answer another i.e., ‘how is the nature of risk culture revealed in efforts to manage it?’ In addition, both from our prior assumptions developed from desk research of practitioner and academic writings and from our data, it is clear that ‘good versus bad’ risk culture is far too binary a view of what is at stake. Rather, we focused on how organisations seem to deal with a number of explicit and implicit trade-offs underlying the bandwidth between risk-taking and control.

This line of enquiry into trade-offs has led us not to the traditional inner core of culture – the attitudes and habits of individuals – but to a different and equally interesting set of interlocking building blocks: designs for oversight structures; efforts to enhance the organisational authority of risk management, interactive and networking capabilities, the real organisational life of risk appetite in the form of limits and tolerances, the openness of organisations to outsiders of various kinds in progressing change, the extent of the footprint of the regulator on organisational processes and choices in designing leverage over behaviour – ethical renewal or new performance management disciplines.

We do not pretend that our focus on these issues is either exhaustive or uniquely original. It is simply that these issues, and the choices they posed, seemed to be at the centre of our open-ended discussions with organisations about their approach to risk culture. They are simply what we observed.

It is said that culture is not about the messages organisations send to their participants, but how they are received. From this point of view, we admit the limitations of our research, being focused primarily on the risk function, which is more in the position of ‘risk culture’ diffuser and influencer. How risk culture really plays out in what is now called the ‘First Line of Defence’ is clearly important but we were only able to have limited insights into this. Clearly there is a need for more work to understand how risk culture change programmes have landed. Relatedly we picked up many differences between banks and insurers, some obvious and some less so, and this deserves more analysis in the future.

Chapter 10: Conclusions

Although we talked to individuals in individual organisations, including advisors, we are conscious that these are not the only relevant levels when discussing risk culture. We strongly suspect that there is a trans-organisational regulatory culture which is not organisation-specific and which can be characterised by a range of shared attitudes to rules, compliance, evidence and due process. This phenomenon also needs more analysis. Although it will not be easy to investigate, its existence helps to explain the institutional durability of practices, despite their widespread criticism. Taking the issue of levels even further, it has been said that financial services is a 'bubble industry' disconnected from the rest of society. Critics say that the industry thought it was bigger than society. From this point of view, the focus on risk culture is symptomatic of a desire to reconnect financial organisations, as a totality, to society via their clients and also via the reconstructed pride of their employees.

We have investigated risk culture at a particular point in time and phase of the business cycle. How some of the changes described in our report fare as market and economic confidence returns are open questions. We also cannot rule out the possibility that the regulatory focus on risk culture and oversight has been a kind of temporary substitute for more stringent interventions to break organisations into smaller units. Only time will tell.

We have not sought to position our work explicitly as another advisory offering, preferring to find things out and display the variety of what we have encountered. However, we have taken the opportunity to pose some challenges to financial organisations, to CROs, CEOs and their boards. The challenges are not easy to address, but we see them as a kind of path to greater awareness of what is at stake in sustaining a risk culture, with all its trade-offs, that the organisation and its stakeholders actually desire, rather than one that just somehow happens.

Finally, we repeat our thanks to the many individuals in banks, insurers and advisory organisations who responded to our request for engagement. It is probably part of the culture of financial organisations and their advisors that they are not naturally open to admitting external researchers. Too many issues are understandably proprietary. We have been unusually fortunate in all our participant organisations for the access they have afforded us, for their trust in our processes, for their time and candour in interacting with us, and above all for accepting the idea that reports like this might be for public rather than private benefit.

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Appendices

Appendix B: Methods

As outlined in Chapter 2 of the main report our aim was for collective knowledge production – working together with Chief Risk Officers and other relevant organisational actors to arrive at a shared view of the cultural factors that drive risk-taking and control within banks and other financial institutions. To achieve this end, our research combined qualitative and survey methods. Figure 6 summarises the methods that we used.

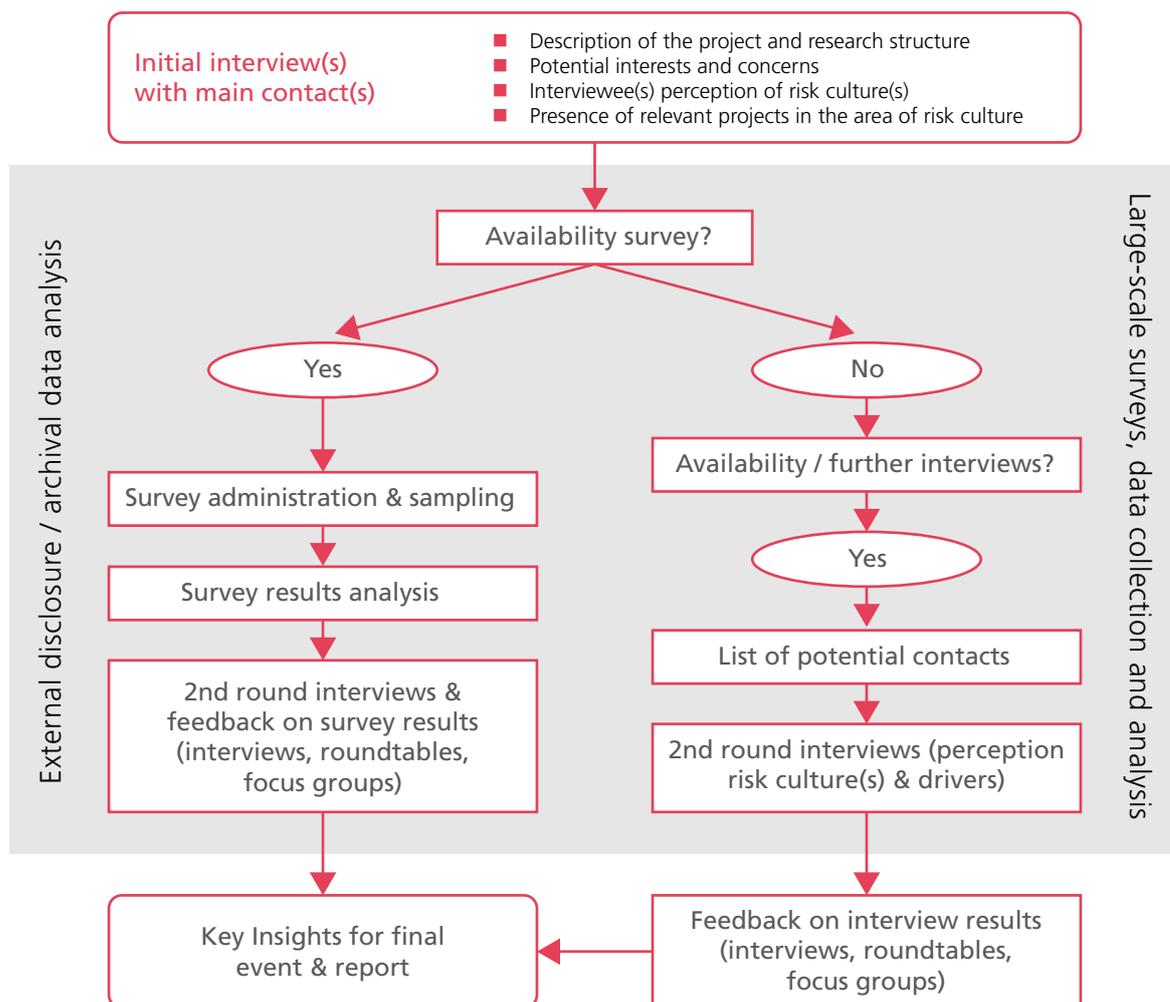


Figure 6: Research Model

Our research began with initial interviews in nine organisations, from across the financial services sector. These interviews provided a breadth of perspective, ranging from large providers of various types of financial services (e.g. insurance, investment and retail banking) operating on a global scale to much smaller organisations operating locally in the UK. A total of fifteen individuals were interviewed, of which ten held a senior position in the risk management area of the organisation (e.g. CRO or deputy CRO). Furthermore, we enriched our understanding of the field with two additional interviews with senior representatives from relevant regulatory organisations.

Appendices

These initial interviews were supported by an outline agenda (see Box 28), to provide a degree of structure and focus to the proceedings. However, we were flexible in the use of this agenda, allowing the discussion to flow into any other areas that the interviewees perceived to be of importance. Where permitted, the interviews were recorded and transcribed, to allow more detailed data analysis and the use of accurate quotations from the respondents to convey their meaning and intentions more fully. Where recording was not permitted contemporaneous notes were taken and added to a set of post interview observations. In all cases at least two of the main researchers were present for each interview, often all three. The researchers took turns in leading the interviews to prevent any specific interviewer bias.

Box 28: *Initial interview agenda*

- Description of the project and research structure.
- Your support for the project and any concerns or questions that you might have.
- Risk culture in your organisation: your organisation's perspective on risk culture; current organisational priorities; past, present and future projects; etc.
- The core drivers of your organisation's risk-taking and control activities.

The analysis of these interviews provided a rich array of themes, plus a number of further research questions, as outlined in our Interim Report (Ashby, Palermo and Power, 2012). These themes and questions were then investigated further using a combination of internet-based short survey instruments (using the distribution tool 'Survey Monkey') and follow-up face-to-face sessions. Two broad surveys of financial services professionals were taken from the CII and CIMA UK membership bases, as well as four organisation-specific surveys looking at risk culture within a sub-set of the organisations visited as part of our initial research interviews.

The purpose of the large scale surveys was to highlight broad industry themes regarding risk culture, and to provide some benchmark results against which the organisation-specific surveys could be compared. Each survey used a Likert-scale approach which gauged the extent to which the respondents agreed with the statements that were provided. These statements explored factors such as the organisation's attitude to risk and risk management; the importance assigned to risk control processes and procedures, compliance and regulation; its ability to respond to loss events and the use of performance measures. In addition the respondents were asked to indicate the amount of time they spent on certain risk related activities (e.g. risk reporting and regulatory compliance) as well as the frequency of interaction between actors such as business risk takers and the risk function. Copies of the two surveys are available on request.

In total the CII survey yielded 2,258 responses, while the CIMA survey yielded 89 responses. The CIMA survey was sent out to 5,000 members who work in finance including a range from very senior members to newly qualified members. The CII survey was sent out across its membership base, covering areas such as broking, underwriting, claims and the London Market, as well as the more general financial services sector including financial advisors, bancassurance, mortgage advisors, and life and pensions. The survey was mailed to approximately 80,000 people. The total number and response rate of the CIMA survey was more limited than the CII survey, which may be symptomatic of its large and diverse membership base. Unfortunately this means that while we have a stronger set of data on which to benchmark the short surveys which we undertook in insurance organisations, we do not have the same for the banking organisations.

In terms of the organisation-specific short surveys, our aim was to capture the different aspects of their risk-taking and risk control activities, using similar questions to those included in the industry surveys. Each survey was customised to a degree to meet the needs of the cooperating CROs, so their results are not always directly comparable. However we do not see this as a limitation. Our willingness to permit customisation increased the level of support we received and in any case the main purpose of these surveys was to enable further discussion based on the survey's results by means of a feedback and focus group session.

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To date, feedback and focus group sessions have been completed within three of the four cooperating organisations to which surveys were distributed. Time limitations and the availability of key organisational actors have prevented a similar session in the fourth organisation, but we expect that this will be complete by the end of October 2013. In two of the three completed sessions we were able to record and transcribe the discussion. In the third this was not permitted, necessitating the taking of contemporaneous notes. In all cases post meeting observations and reflections were also recorded by the researchers to add further context. Once again at least two of the main researchers were present at each session, usually all three.

In addition to the surveys and follow-up feedback and focus group sessions, we have continued to conduct a range of interviews to further check and validate our analysis and increase its longitudinal relevance. Follow-up interviews were completed with all but two of the organisations with which we had initial meetings, as well as further meetings with relevant regulatory actors. As our thinking developed we also complemented our work with a number of meetings with some consulting organisations that are currently active in the area of risk culture, having developed or being in the process of developing risk culture products for their clients.

Interviews were also completed with risk management specialists from within and also outside the financial services sector. This included an organisational psychologist who worked with financial institutions and a number of safety experts from the aviation and other industries. A full summary of all the individuals that we interviewed is at the end of this appendix, including the number of interviews and the total amount of formal contact time. Note that the level of information is necessarily restricted to ensure the anonymity of our interviewees and their organisations.

Overall, we built four complementary sets of empirical material. The first relates to organisations where we had an initial meeting with key actors (e.g. CROs), administered an internal short survey, and finally ran a follow-up workshop/focus group with managers representing various areas of the business (e.g. CEOs, CROs, Business Managers, Heads of Compliance, Internal Auditor, HR partners). The second relates to organisations where we met with various organisational actors over the period of the research. In all cases, we were able to meet at least twice at least one of our informants. Hence, we were able to get a sense of the progress around risk culture change initiatives in these organisations. The third is constituted by various interviews with relevant actors in the field, including corporate senior managers, consultants and regulators. We were able to meet with some of the consultants, who are currently developing tools around risk culture, more than once over the period of the research. Hence, we developed an understanding of the issues that the advisory market faces in the design and implementation of risk culture tools. We also have some material from outside the financial services sector (see Table 5 and Table 6).

Finally our research activities were informed by an on-going review of the academic and practitioner literatures, as well desk research of pertinent publicly available documents. We especially note the growth in public institutional interest in the topic of risk culture (i.e. regulators, politicians, professional/trade associations) where during the life of this project a wide range of reports, policy documents and good practice guides have been produced. These documents, along with all the other pertinent literature are reviewed in Appendices C.

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Organisation's code and description	Interviews	Customised surveys	Survey follow-up seminar	No. people met (hrs contact time)
INS_1 Multiline specialist commercial insurer and reinsurer. Primarily involved in the Lloyds market	<ul style="list-style-type: none"> June 2012: CRO 	January-March 2013: 84 responses	May 2013: 7 participants incl. CRO, ERM, Compliance, underwriting and others	7 (3.5)
INS_2 UK life subsidiary of an insurance conglomerate	<ul style="list-style-type: none"> July 2012: Head of ERM, Head of Corporate governance 	January-March 2013: 45 responses	May 2013: 10 participants, including CEO, CRO, COO, HR staff and others risk staff	12 (4)
BANK_1 UK investment banking subsidiary of a larger banking group	<ul style="list-style-type: none"> November 2012: Head of Operational Risk (by telephone) July 2013: Head of Operational Risk 	January-March 2013: 18 responses	June 2013: 4 participants including CEO, Head of Market Risk, Op Risk	4 (3)
INS_3 Multinational banking and insurance group	<ul style="list-style-type: none"> July 2012: CRO, Head of Risk and Regulatory February 2013: as above 	May-June 2013: 27 responses	Scheduled for October 2013	2 (3.5)
INS_4 International insurance conglomerate	<ul style="list-style-type: none"> May 2012: Group Risk Director, HR Director, Solvency II Director January 2013: Group Risk Director July 2013: Group Risk Director, HR partner, Enterprise Risk Director 	N/A	N/A	6 (3.5)
BANK_2 Internationally active bank, focusing on retail banking	<ul style="list-style-type: none"> June 2012: CRO, Deputy CRO June 2013: as above 	N/A	N/A	2 (2.5)
BANK_3 Internationally active bank, focusing on retail banking	<ul style="list-style-type: none"> July 2012: CRO, EA to CRO July 2013: Risk Chief Operating Officer, Operational Risk Director 	N/A	N/A	4 (2.5)
BANK_4 Internationally active bank, focusing on retail and investment banking	<ul style="list-style-type: none"> April 2012: Group CRO June 2013: Group CRO, 'Risk culture champion' 	N/A	N/A	2 (2.5)

Table 5: Data collection - Participant Organisations

Appendices

Description	Interviews and Meetings	No. people met (contact time, hours)
CRO at insurance conglomerate, focusing on retail insurance products	<ul style="list-style-type: none"> ■ June 2012 	1 (1)
CRO at regional building society	<ul style="list-style-type: none"> ■ May 2012 	1 (1.5)
Executive director at UK regulatory agency (REG_1)	<ul style="list-style-type: none"> ■ September 2012 	1 (1)
Policy advisors at UK regulatory agency (REG_2)	<ul style="list-style-type: none"> ■ September 2012 	2 (1)
Various staff at an international consulting organisation and auditor (CONS_1)	<ul style="list-style-type: none"> ■ January 2013: Senior Manager, FS, Director Human Capital ■ May 2013: Senior Manager FS, Director FS Risk ■ June 2013: participation in dinner for insurance CROs ■ June 2013: Senior Manager and Manager, Financial Services Practice; Senior Manager, HR Consulting Practice 	6 (6)
Staff at an international consulting organisation (CONS_2)	<ul style="list-style-type: none"> ■ December 2012 	2 (2)
Staff member of an international financial services provider and consulting organisation (CONS_3)	<ul style="list-style-type: none"> ■ January 2013 	1 (2)
Various staff at airline industry (AIRLINE)	<ul style="list-style-type: none"> ■ May 2013: Head of Safety, Head of Safety Performance, Safety staff (x4) 	6 (7)
Staff at industrial company	<ul style="list-style-type: none"> ■ July 2013 – Head and Deputy Head of Group Risk 	2 (2)

Table 6: Data collection – Additional interviews and meetings

Appendices

Appendix C: Risk culture in practice

As noted in our report, discussion and debate about risk culture is more advanced in the field of practice than it is in academia. This Appendix supports our main report by providing a critical review of a number of relevant practitioner contributions and outputs with the aim of highlighting some of the key themes and assumptions they make, both concerning the nature of risk culture and the capability of organisations to manage and intervene in it.

This review is divided into two main sections. In the first part we review the various opinion pieces, white papers, surveys, marketing materials and assessment products that have been produced by a wide range of specialist consulting firms on the subject of risk culture. Consulting firms are very important actors in shaping organisational responses to regulation and in developing benchmarks of best practice. Having privileged access to a wide range of organisations, they are often the first to identify emerging issues and to provide new conceptualizations – often visual in form – to characterise these issues. Consulting firms compete with each other to be at the cutting edge of management disciplines and to position themselves as credible advisors. The context of risk culture, and organisational culture more generally, is a perfect illustration of the role and power of consulting organisations like McKinsey who have helped to ‘discover’ and shape organisational receptions of the concept (Bower, 1966). Similarly, in a related area such as risk appetite, consulting organisations have developed an extensive literature in comparison to the relative paucity of academic work (see: Ashby and Diacon 2012; Power, 2009). This academic neglect is interesting in its own right but is not the subject of this review.

In the second section we review the work that has been produced by regulators, politicians, professional institutes and industry associations on the subject of risk culture. This mostly relates to a range of consultation papers, published speeches and reports, some specifically on the topic of risk culture, and others referring to it in relation to other areas, such as the maintenance of effective governance and risk management frameworks. In terms of the regulatory papers and political reports it is probable that some of their content will become regulatory policy in the future.

Consulting Organisations

The literature from consulting organisations can generally be organised into three main categories: 1) surveys of firms that include questions that relate to risk culture; 2) papers and opinion pieces on the definition, role and importance of risk culture, along with the elements of a ‘strong’ or ‘weak’ culture and 3) risk culture assessment and management tools. The following tables (Table 7 and Table 8) highlight a selection of significant documents produced on the topic by consulting organisations. Table 8 reflects elements 2 and 3 together since many documents combine the two.

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Source	Title
Deloitte (2010)	Risk intelligence in the energy and resources industry enterprise risk management benchmark survey
Deloitte (2011)	Global financial services risk - Management Survey
Deloitte (2011)	Global risk management survey
EandY (2011)	Making strides in financial services risk management
EandY (2012)	Progress in financial services risk management – A survey of major financial institutions
EandY (2012)	Turning risk into results – How leading companies use risk management to fuel better performance
EIU (2009)	Beyond box-ticking - A new era for risk governance
IRM (2011)	Risk management embedding and risk culture – survey
KPMG (2009)	Never again? Risk management in banking beyond the credit crisis
KPMG (2009)	Operational risk management (ORM) - US insurers
KPMG (2010)	Risk Management - A driver of enterprise value in the emerging environment
KPMG (2010)	Highlights from the 2010 KPMG Singapore Enterprise Risk Management Survey Briefing
KPMG (2013)	Expectations of risk management outpacing capabilities – it's time for action top eight risk management imperatives for the c-suite in 2013
Marsh (2012)	Risk management benchmarking survey results
Protiviti (2012)	Risk culture: not a tick box exercise – findings from a survey of the UK insurance industry
PWC (2011)	Raising the bar for risk management: Benchmarking risk management practices in the banking industry in EMEA

Table 7: Selected surveys including questions on risk culture

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Source	Title	
Deloitte (2009)	Solvency II and SST - Beyond quantitative models	Road map for Solvency II - including a risk culture item
Deloitte (2010)	Insurance Learning-on-the-Go	Risk and solvency assessment (ORSA) - including a risk culture framework
Deloitte (2010)	Remuneration policies in the financial sector	Providing a risk culture framework
Deloitte (2011)	Human capital advisory services	Toolkit to include risk culture in performance assessment and reward
Deloitte (2011)	Risk and regulatory review - The risk return proposition	Toolkit on "How to make a strong risk culture your competitive advantage"
Deloitte (2012)	Cultivating a risk intelligent culture – Understand, measure, strengthen and report	Toolkit and framework for assessing and managing risk culture
EandY (2011)	Growth in uncertain times - The need for dynamic risk management	5 steps to "Understand and drive the right risk culture"
EandY (2013)	The cultural revolution in risk management	Paper in EandY's house journal (The Journal of Financial Perspectives) that proposes a model for assessing and strengthening risk culture.
IRM (2011)	Risk guidance paper appetite and tolerance	Risk culture diagnostic within risk appetite guidance document
IRM (2012)	Risk culture - Resources for Practitioners	IRM risk culture framework
KPMG (2008)	Understanding and articulating risk appetite	Framework on risk appetite including a risk culture item
KPMG (2009)	What is your company's risk culture?	Offers advice on the factors that can affect an organisation's risk culture and the elements of a strong culture
McKinsey (2010)	Taking control of organisational culture	Risk culture framework and risk culture diagnostic approach
McKinsey (2013)	Managing the people side of risk	Offers advice to organisations on how to create a 'powerful' risk culture
PWC (2007) and (2012)	The risk culture survey	US specific risk culture diagnostic tool – discusses the value of risk culture surveys and outlines the PWC US practice's risk culture model
PWC (2009)	Building a risk aware culture for success	Global GRC marketing document outlining how PWC can help organisations to assess risk culture
PWC (2011)	Building effective risk cultures at financial institutions	A framework where "risk culture forms one of the underlying foundations for managing risk"
Towers Watson (2012)	The need to build a strong risk culture is growing – Effective diagnostics support a positive culture	Risk culture diagnostic tool, built around the assessment of a risk culture questionnaire

Table 8: Selected guidance and toolkits on risk culture

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We should emphasise that it is not our intention to single out specific consulting organisations for praise or criticism for their approach to risk culture. Rather, we think it more useful at this stage of development of the advisory field to highlight some of the common elements in this practitioner literature, as these have helped to inform our own analysis and findings in the main body of this report. We also raise a few notes of caution about the overall general direction of this advisory work and the validity of some of the more popular assumptions that are made.

We organise observations and analysis of the practitioner work on risk culture around the following key themes:

- The role of risk culture
- Reductionism, positivism and auditability
- The risk culture ideal
- Structures versus behaviours
- Manipulating risk culture: project orientation

Theme 1: The Role of Risk Culture

From our review of the literature it is striking but understandable that consulting organisations perceive risk culture positively as an enabling force which helps to improve the effectiveness and embeddedness of risk management processes and procedures, along with associated risk governance and internal control frameworks. Indeed, on this view risk culture is the child of the COSO conception of ‘control environment.’ It embodies an aspiration for improved risk management decisions and risk governance to ensure that an organisation’s decision makers maintain an appropriate level of risk control. In this regard risk culture is very commonly closely linked to an organisation’s risk appetite policy statement, since this statement is taken to be the tangible and formal representation of the implicit limits that decision makers will impose on themselves (both individually and collectively). Risk appetite and its internal enforcement are therefore regarded, with good reason, as the visible manifestation of risk culture. In addition, many consulting documents and frameworks emphasise the need to ‘align’ risk culture to formal risk management frameworks/practices. This is implicit and often explicit acknowledgment that the gap between the two lay at the heart of many problems in financial organisations. Frameworks must be accepted, understood and operationalised by employees and this alignment necessarily makes human factors a much more important element of risk management than hitherto. Indeed, as we note elsewhere in this report, the interest in risk culture is largely driven by recognition of the need to reconnect financial risk management to an understanding of human behaviour and motivation.

A good example of the enabling and embedding role of risk culture comes from Protiviti (2012). In a survey of insurance firms Protiviti conclude that risk culture is a “vital component” in the effectiveness of risk management processes and practices that can help employees to understand and accept that risk management is “everyone’s responsibility”. Protiviti also stress the importance of ‘aligning’ risk culture with a firm’s risk management framework and practices.

Several of the larger audit/consulting firms such as KPMG and PWC also share this view. In the case of KPMG their position is developed in two key papers. Farrell and Hoon, (2009) emphasise the behavioural and internal control aspects of risk culture, suggesting that it is a means to ensure that employees are “doing the right thing” and that they “understand risk and compliance rules”, leading them to make appropriate risk-taking and control decisions. KPMG (2010) goes even further, using a cross-sector survey of organisations to show how risk management can ‘drive’ enterprise value. Here risk culture is said to form the foundations for effective risk management – underpinning three more tangible and procedural pillars for effectiveness: risk identification and assessment, risk quantification/mitigation, and risk monitoring/reporting.

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Similarly PWC (2012) links risk culture to 'effective' and 'sustainable' ERM suggesting that an effective risk culture helps employees to understand the level of 'acceptable' risk along with how risk information should influence their decisions. PWC even make the claim that there are studies which show that a strong risk culture can lead to a reduction in loss events, along with better performance management. No evidence however is provided to back up this claim. Indeed, the practitioner literature generally argues from examples of 'deviant' risk cultures which led to problems, rather than providing evidence of the positive benefits. This is consistent with a point we make elsewhere in this report, namely that many conceptions of risk culture within practitioner documents are implicitly conservative and precautionary in substance.

On the relationship between risk appetite and risk culture Ernst and Young (De Jonghe et al., 2013) provides one of the more developed practitioner views on this topic. In this paper the authors argue that risk appetite and risk culture are closely related 'reinforcing' mechanisms. The mechanism for this relationship is that an organisation's stated risk appetite should affect decision-making behaviours and hence risk culture; while an organisation's risk culture helps to determine whether its stated risk appetite is embedded and accepted. So in this respect risk appetite is seen to represent a more formal and tangible perspective on risk attitudes; risk culture a more informal and implicit one. The authors go on to suggest that a 'strong' risk culture will allow organisations to achieve an appropriate balance between risk and return, while those with 'weak' risk cultures will either take too little or too much risk – though excessive risk-taking is assumed to be the most common case, which again points to an implicit conservatism in the representation of risk culture.

So for the most part, and with the partial exception of Ernst and Young, it would seem that risk culture is largely articulated as a brake on 'pure' downside risk. Implicitly, whether intended or not, many consulting firms frame risk as a bad thing that is to be controlled (reduced) via the 'mechanism' of risk culture. Risk culture provides a natural constraint on 'bad' behaviours (excessive risk-taking) and ensures that risk management processes and procedures are accepted and performed in an effective manner. Thus, notwithstanding the significance attached by advisors to risk culture, it is largely conceptualised as a mechanism for controlling the behaviours of decision makers. In this way, risk culture is implicitly linked to very traditional ideas of risk management as a mechanism for ensuring an appropriate degree of risk aversion, rather than as a means of adding direct value to organisations via the exploitation of strategic opportunities.

Theme 2: Reductionism, Positivism and Auditability

All of the consulting organisations that have chosen to comment on the topic share the view that risk culture is something that can be distilled down into a relatively small number of factors. These factors are then categorised further (usually into 4 main elements or dimensions) and are often presented in the form of a wheel. Table 9 provides a summary of the main categories of factors that have been identified by those consulting organisations which have developed relatively formal 'models' of risk culture. For comparison purposes the Institute of Risk Management's 'Risk Culture Aspects ModelTM' is also included.

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Factor Categories	Deloitte	Ernst and Young	IRM ¹	KPMG	McKinsey	PWC	Towers Watson
Acknowledgement of risk (potential for over confidence, level of challenge)			✓		✓		
Communication (regular risk reporting and escalation of risk issues)			✓		✓	✓	✓
Compensation and performance management	✓	✓	✓			✓	
IT Systems							✓
Leadership ('tone from the top')		✓	✓	✓		✓	✓
Relationships (between employees)	✓						
Respect for risk (potential for gaming the system)					✓		
Responsiveness to risk (ability to react to risk issues)					✓		
Risk competencies (of employees)	✓		✓			✓	
Risk facilitation (status of risk function and ability to support business)			✓	✓			
Risk management processes and procedures						✓	✓
Risk ownership (clear accountabilities)			✓	✓		✓	
Structure of organisation and governance	✓	✓	✓				✓

Table 9: Summary of risk culture model factors by organisation

From Table 9 it is clear that there are considerable surface differences between the various 'models' of risk culture provided by these organisations. Unsurprisingly, the most common factor across the advisors is leadership and 'tone from the top' in particular, a concept borrowed from the mainstream literature on organisational culture and in particular Schein (2010). Also popular are categories relating to compensation and performance management – the idea being that risk culture is reflected in large part by the financial motivations of employees. Similarly organisational structure and governance is a popular category, as is risk communication and reporting. This category further reinforces the notion of risk culture as a control tool – it being reflected in how employees are constrained in terms of their decision-making (through monitoring, incentives, etc.). This is consistent with what we what observe elsewhere in this report, namely that while ethical and behavioural issues are part of the public debate about risk culture, internally organisations seem to be addressing these issues with new structures, renewal of existing processes and revised performance management systems.

¹ The IRM's 4 categories of 'Tone at the top', 'Decisions', 'Governance' and 'Competency' are quite broad and cover more than 4 of the factors listed here. The same is also the case for PWC and Towers Watson.

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Perhaps the most dominant common feature of all these models is a general aspiration to measure risk culture. Many consulting organisations have developed formal risk culture assessment tools and it is common for them to generate percentage risk scores for the identified risk culture factors, scores which are usually then RAG rated as 'Red', 'Amber' or 'Green'. No public information is provided on the mechanisms used to generate these scores or the means by which RAG thresholds have been determined. However we presume that the idea here is to help organisations to somehow quantify and track risk culture in terms of measured factors and to prioritise those that seem to require attention. An improving risk culture is reflected in increasing the factor scores over time.

We have no doubt that advisors recognise the complexity and richness of cultural issues in organisations. The issue is not one of naivety on their part. Indeed, from our discussions with several advisors it is clear that quite the opposite is true. Rather, it reflects a deeply held view that something like risk culture simply cannot be made actionable without being reduced in some way to a few visible characteristics. This is another way of stating the persistent managerial notion, which we heard many times, that 'if it can't be measured, it can't be managed' a quote often misattributed to the management guru Prof Peter Drucker² and even repeated in the IRM's work on risk culture (IRM, 2012: 13). However, a fuller investigation of the works of management thinkers such as Drucker or Deming shows that they do not share the notion that management requires measurement. Indeed Deming explicitly warned against running a company on visible figures alone in his seven deadly diseases of management (Deming, 1986).

This question of reduction and measurement seems to be one of the most fundamental issues in the entire risk culture debate at the practitioner level. Without some kind of tool, advisors feel insecure having only words and qualitative judgments to offer. Yet we also observe that there is another force at work in the field of risk culture in financial organisations, namely regulatory demands for auditability.

From a reading of practitioner documents combined with our own investigations, we conclude that efforts to attempt to categorise and score risk culture reflect a strong desire to demonstrate that something is being done and to make it auditable by regulators and, potentially, internal auditors. The auditability imperative has two parts. First, the thing in question – risk culture – must leave durable traces in the form of scores etc. which can be checked by others (Power, 2013). Second, these traces of risk culture, however imperfect, must be benchmarked against a set of agreed criteria, allowing a comparison to be made of an 'actual' risk culture against some kind of ideal. This permits 'gaps' to be identified which can then be the subject of further interventions to improve the scores/traces next time. We discuss further below the ideals which make this gap analysis possible.

Theme 3: The Risk Culture Ideal

From our review of the relevant literature there appears to be an underlying agreement among consulting organisations that there are clear differences between 'strong' and 'weak' cultures. This implies that there is some kind of ideal to which firms should aspire. However, just as with the risk culture factors identified in Table 9 above, there is less consistency over the precise elements attributed to a strong or weak culture.

One observation that is common to most consulting organisations relates to the generic nature of the elements that are identified as typifying a strong culture. Many of these elements have more in common with good management practice in general, than anything specific in terms of risk culture. Indeed, this blurring of focus is quite common in discussions of risk culture, suggesting that it is an abstraction from a wide range of interconnected processes.

² See: <http://thedx.druckerinstitute.com/2013/07/measurement-myopia/> .

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A good example of this blurring and merging of advisory agendas is the 'Risk Intelligent Culture' framework proposed by Deloitte. This work highlights various 'enablers' (for example: leadership commitment, communication, measurement and reporting and programme management) to help strengthen an organisation's risk culture and to promote "continuous cultural improvement" (Deloitte, 2012: 4). Here we observe close parallels with the managerial concept of Total Quality Management and the philosophy of Continuous Improvement.

In contrast Ernst and Young (De Jonghe et al., 2013) draw more from the field of corporate governance (particularly Ernst and Young's own 2011 survey of risk governance practices), emphasising the following elements of a strong risk culture: a consistent 'tone from the top', appropriate metrics that are monitored regularly, effective escalation processes and an 'open' culture in which employees feel able to raise concerns and the consistent enforcement of process/limit breaches. This governance positioning of risk culture is shared by Protiviti (2012) who use survey evidence to emphasise two key factors: non-executive challenge on a firm's risk management activities and the frequency of board discussions on risk management.

Similarly both KPMG (Farrell and Hoon, 2009) and McKinsey (Levy et al., 2010) add some common examples of good risk management practice to those of good governance:

- Leaders/managers who set a clear risk strategy and support their organisation's risk management policies and procedures, so their teams know that non-compliance will not be tolerated (again this implies risk culture as a control mechanism)
- The clear and consistent communication of an organisation's values and ethical codes of conduct by management
- Incentives to behave appropriately and 'do the right thing' from both a risk management and an ethical perspective
- Having a consistent process for considering risk when making decisions
- Recruiting the right staff who are compatible with the prevailing risk culture

The fact that consulting organisations often identify different elements for a strong or weak risk culture, and in some cases even have different conceptual foundations for these elements, suggests that there is no clear or precise agreement in this area. In addition specifications of risk culture necessarily overflow into more general understandings of culture, governance and management. This fuzziness seems to be an essential feature of risk culture debates by advisors and challenges the idea that there is some kind of ideal benchmark for examining risk culture strength that needs to be 'discovered'. Our own findings presented elsewhere in this report also highlight the plurality of aspects at stake in risk culture change programmes in financial organisations, and provides further reason for caution in attempting to define precisely the dimensions of risk culture strength even though there are common elements. The same pluralism is visible in academic analyses of organisational and safety culture (e.g. Schein 2010; Weick and Sutcliffe, 2007) and to date there is no common view.

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Theme 4: Structures versus Behaviours

Mirroring the academic literature on organisational culture and safety culture (see Chapter 2) certain consulting organisations emphasise a range of structural factors when assessing risk culture or discussing the elements of a strong culture, while others are more behaviorally focused.

Table 9 suggests that PWC and Towers Perrin adopt more structural approaches to modeling risk culture, emphasising factors such as the design of an organisation's risk management policies and procedures, along with communication and governance structures. In contrast Deloitte, KPMG and McKinsey have more apparently behaviorally orientated approaches, as does the IRM's 'Risk Culture Aspects Model™'. Behavioural approaches emphasise factors such as employee risk competencies, 'tone from the top' and risk function behaviours, the aim being to ensure that employees 'do the right thing' and understand risk and compliance rules.

And yet the snapshots provided in Table 9 do not mean that particular approaches are exclusively behavioural or structural, just that some are further along one spectrum or the other. Indeed, we would expect this since, as we have stated at numerous points in our report, the explosion of risk culture reflects an interest and desire to reconnect process/structure to behaviour in the risk management field.

Theme 5: Manipulating Risk Culture: Project Orientation

The final theme that emerges from the literature produced by consulting organisations relates to the way in which they believe that risk culture 'management' should be organised. All of the consulting organisations we have reviewed recommend the following basic structure to risk culture management (see Figure 7).

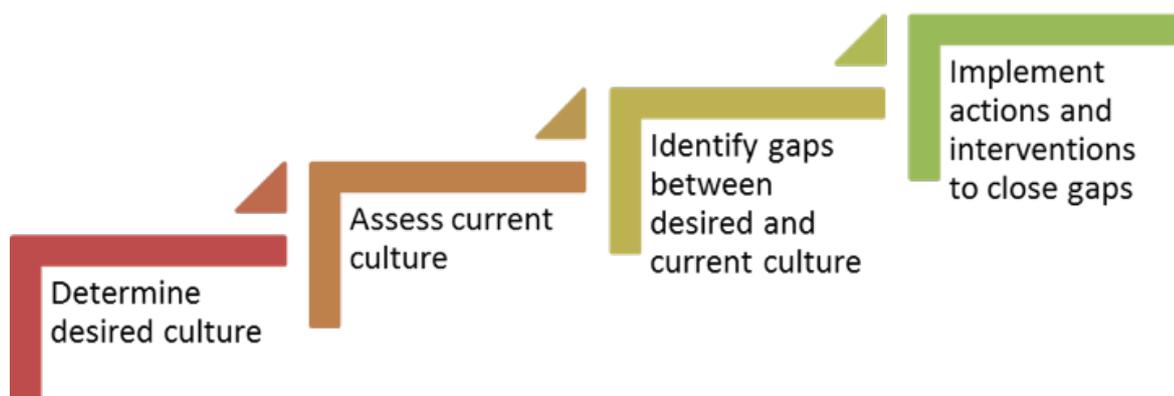


Figure 7: Manipulating risk culture

This structure has strong parallels with a typical audit and evaluation process. However it is also interesting to note that most of these consulting organisations further recommend that the final stage in this process should be organised in the form of a change management project, although we have identified broad differences in our study between those adopting an organic approach to change and those with a more engineered programme.

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The notion that risk culture should be managed in the form of a project is entirely logical from a managerial point of view and shows how advisory firms build on their existing knowledge and experience in other areas when address new objects of interest. For example, popular management philosophies such as TQM have been applied to the area of risk culture. These and other approaches imply that risk culture, like quality perhaps, is something to be managed for a discrete and relatively short period of time, as with any other project. This assumes that risk culture is something that can be changed in an organised and structured way, making it into a bounded 'problem' that can be solved in isolation from the day-to-day management of the organisation.

These constructions of risk culture sit uneasily with an understanding of it as an organic phenomenon that pervades all aspects of organisations risk-taking and control activities and is frequently changing and evolving, even without the active intervention and direction of management (see Salz, 2013). Organisations have always had risk cultures in some sense without being self-conscious about them. This means that this collection of ways of risk-taking and control may not be amenable to heavy re-engineering through the implementation of a time and space-bounded change project, unless perhaps this follows a period of significant organisational disruption and dissonance (e.g. following a crisis of some kind) that opens the organisation up to the potential for major cultural change. It is for this reason that we build our contrast in the main body of the report between organic and engineered approaches to risk culture. While many advisors recognise the reality of the former, they are institutionally committed to viewing risk culture through the lens of the latter. This is a significant dilemma for consultants and the organisations they advise, which we address in our findings.

Regulators, Politicians, Institutes and Associations

In comparison to the consulting literature, there is relatively little output on the subject of risk culture from regulators, politicians, institutes and associations. However the level of interest and commentary from these organisations is growing quickly. In particular there has been a significant growth in output since 2009 and especially during the life of this project (2012-13).

Regulators

From a UK perspective this work can be divided into international and domestic (including EU) output, with the majority of the consultation papers and reports that discuss the topic of risk culture being at the international level.

The growth of international level political and regulatory attention to risk culture began in 2009 following the financial crisis, a major development being the recognition by the Basel Committee on Banking Standards (the main international body for negotiating cross-border banking regulation) that culture has a key role to play in risk management. In the initial post-crisis reforms of the Basel II Accord (so called Basel 2.5) the Committee stated that: "risk management must be embedded in the culture of a bank" and went onto say that risk culture should be a "critical focus" of all decision makers (Basel Committee on Banking Supervision, 2009) this statement being all the more significant given the Basel Committee's more remote stance on risk management practices in the original Basel II Accord:

"It is not the Committee's intention to dictate the form or operational detail of banks' risk management policies and practices." (Basel, 2006: 2)

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In terms of managing risk culture the Basel Committee offered some initial thoughts in its 2009 reforms of the second Accord, which are then developed further in the guidance it produced on the governance of internationally active banks (Basel, 2010b) and the management of operational risk (Basel, 2011). Predictably, and in common with what we observe in consulting outputs discussed above, this guidance has a strong focus on the more tangible internal control aspects of risk culture, with the committee highlighting factors such as compensation policies (suggesting they should be long term and linked to clear risk management objectives) and the role of risk culture in helping to cement the TLD approach to governance (e.g. by helping decision makers to understand and accept their roles and those of the other three lines). However, this structural emphasis does not mean that the Basel Committee ignores the more behavioural aspects of culture, though the mechanisms it proposes to 'control' behaviour remain highly tangible and procedural. Notably in the governance paper (Basel 2010b) the Committee calls for the development of corporate cultures that highlight and embed appropriate norms and incentives for professional and responsible behaviour, linking this to the creation of an appropriate 'tone from the top' and the setting of professional standards, values and incentives that promote integrity and clarify appropriate and inappropriate behaviours. This view is reiterated in the operational risk paper (Basel, 2011), where Principle 1 makes it clear that a bank's 'risk management culture' must embody professional and responsible behaviours and that standards and incentives must be set to ensure that these behaviours are adopted. The paper also suggests a link between a bank's risk management culture and ethical business practices. While this is not developed further it provides more evidence of a regulatory desire to re-ethicise organisations via their risk management process in some way.

A similar procedurally focused approach to risk culture is adopted by the Basel Committee's sister organisations - the Joint Forum (which covers matters that relate to the joint regulation of internationally active banks, insurers and securities trading firms) and the Financial Stability Board (which co-ordinates national and international regulatory efforts in a bid to maintain international financial stability). Notably the Joint Forum in a recent paper on financial conglomerates (Joint Forum 2012) suggests that an appropriate group-wide risk management culture should be created. It also goes on to outline various elements of an appropriate culture including: risk management training, independence of the risk function, incentives, risk awareness and whistle-blowing. In addition, the FSB (FSB, 2012, 2013a and 2013b) links the idea of a strong risk culture to good governance and suggest that metrics, such as unclosed audit issues and employee survey results, should be used to monitor the risk cultures of financial organisations – both by management and supervisors. In fact the FSB even goes as far as to suggest that supervisors should be actively involved in assessing risk culture.

The FSB also makes some interesting observations on the relationship between risk appetite and risk culture. These are developed in its very recent paper on risk appetite (FSB, 2013b). As with some of the consulting organisations (see Theme 1 above), the FSB suggests a two-way relationship between culture and risk appetite, where an effective risk appetite framework is said to help "reinforce a strong risk culture", while the paper also suggests that risk culture can help to embed prudent risk-taking and to support risk reporting and escalation. So in this regard culture and risk appetite are seen as mutually reinforcing. However the implicit conception of risk culture is conservative, on the risk-avoiding aspects of risk appetite, the idea being that risk is something that needs to be limited.

From the perspective of international insurance regulation much less has been said on risk culture. However the topic has not completely escaped the attention of the International Association of Insurance Supervisors (IAIS). Here the IAIS's Draft ComFrame regulations (its proposed international regulations for insurers, see IAIS, 2012a)

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talks about developing a risk management system that is embedded into a firm's culture and suggests that the risk function has a role to play in "setting" an insurers risk culture. In addition the IAIS's Insurance Core Principles (IAIS 2012b) suggest that boards/senior management should promote a culture of sound risk management (and compliance), and even suggests that internal models can help to better embed a company's risk culture, though the reason for this is not made clear.

Closer to home the EU's recently published Capital Requirements Directive (CRD IV) includes a new regulatory requirement on risk culture, stating that:

"Member States should introduce principles and standards to ensure effective oversight by the management body, promote a sound risk culture at all levels of credit institutions and investment firms..." (DIRECTIVE 2013/36/EU, paragraph 54)

This statement highlights in European law the importance of risk culture for banking and securities organisations, but provides no further detail on the nature of such cultures. As is customary under the Lamfalussy process of European regulation³ this is left for the European Banking Agency (which replaced the Committee of European Banking Supervisors)⁴ and the various local regulatory agencies such as the Prudential Regulatory Authority and the Financial Conduct Authority in the UK.

In terms of UK regulation neither the PRA nor the FCA (or the former FSA) has produced specific regulation on risk culture. However both the PRA and FCA have indicated that culture and risk culture are areas they intend to look at from a supervisory perspective and they are developing guidance. Once again the link between culture and prudence is evident, with the PRA making clear that to meet its 'Principle of Safety and Soundness' banks and insurers must have a culture that supports this (PRA, 2013a and 2013b), though it does not have any particular 'right culture' in mind. The PRA also states that it expects banks and insurers to minimise incentives for excessive risk-taking via: appropriate incentives, ensuring that responsibilities for risk management are considered as a central part of front-line management and through risk and control functions that carry 'real weight'.

The FCA provides even fewer specifics, but has laid out its position in a speech by Clive Adamson (Adamson, 2013). Here Adamson suggests that the FCA will not assess or legislate on culture directly but that it will "join the dots" using a range of inputs/information (such as how a financial organisation deals with the regulator). However Adamson does make it clear that the FCA wishes to encourage 'positive culture change' and to link culture to 'driving behaviours'. Adamson also identifies three main cultural drivers: tone from the top, business practices and ways of behaving in the organisation below the top management level and performance management via incentives/training.

Understandably, regulatory pronouncements are long on ambition and short on detail. In many respects it is clear that regulators will rely on organisations and their advisors to specify detail and operationalise risk culture. We also suspect, but have no systematic evidence, that regulators themselves use advisors. It is for this reason that our main report begins to explore the idea of a 'regulatory culture' which extends across organisations, advisors and regulators and which plays a very significant role in shaping the reality of risk culture change programmes (Chapter 8).

³ See: <http://www.fsa.gov.uk/about/what/international/european/lamfalussy>

⁴ Notably see CEBS (2010), which provides further European level guidance on risk culture in its high level principles for risk management. This includes the importance of creating a "strong, institution-wide, risk culture", as well as an enterprise-wide risk function that covers all risks and is independent. So again there is a strong internal control theme.

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Politicians

As with regulators, political interest in risk culture has grown since the financial crisis. From an international perspective this interest has been manifested in the G20's support for the work of organisations such as the FSB and Basel Committee. However that does not mean that politicians have been silent on the topic at a domestic level. In particular UK political interest in the cultures and risk cultures of banks has been significant, firstly by the Treasury Select Committee (Treasury Select Committee, 2009a and 2009b) and more recently by the Parliamentary Commission on Banking Standards (PCBS, 2013a and 2013b), where its views on cultural reform form a central part of its analysis and recommendations. Once again the focus is on the internal control and risk limiting aspects of risk culture, with attention devoted to the prevention of cultures that promote excessive risk-taking, via mechanisms such as longer term incentive arrangements, independent risk functions, the creation and enforcement of codes of conduct and professional standards, clear whistle-blowing policies, and the 'tone from the top'. Regulators and advisors have been important contributors to these enquiries and it is no surprise that there is considerable commonality across the political, regulatory, advisory and organisational domains.

Institutes and Associations

In terms of Institutes and Associations two main organisations have been active in providing guidance on the role, assessment and management of risk culture: the Institute of Risk Management (IRM) and the Institute of International Finance (IIF). Both of these organisations have produced dedicated and detailed papers on risk culture.

The IIF paper (IIF, 2009) provides a finance industry trade association's view on the topic. The paper covers a range of issues, including the definition of risk culture, elements of a weak versus a strong risk culture, and the assessment of risk culture. The IIF also provides a number of recommendations for financial organisations in relation to the management of their risk cultures.

Despite being a trade association it is interesting to note that the IIF appears to share a similar perspective on risk culture to the regulatory and political opinions outlined above. Specifically there is a particular emphasis on control, and the elements of a strong risk culture are closely related to how risky decisions are governed and controlled. These elements of a strong culture include: incentives, an effective governance structure with clear accountabilities for risk and risk tolerance limits, escalation of risk issues, tone from the top, etc. So the IIF only reinforces the view that risk culture primarily exists to limit risk-taking, not to facilitate it.

In contrast, the IRM's work on risk culture takes a more neutral view on risk culture and its relationship with risk-taking/control, explaining that a 'successful' risk culture may reflect the organisation's stance on both, rather than simply risk control (IRM, 2012). This view may in part be due to the fact that the IRM's work is not specific to financial organisations. It may also be because the IRM consulted widely, across a range of practitioners from different industry sectors, consulting organisations and academics.

However, despite a more symmetrical stance on the relationship between risk culture and risk-taking and control, the IRM's work has many similarities with that of the consulting organisations outlined above. In particular the IRM strongly promotes the assessment of risk culture. It also provides its own reductive model of risk culture in the form of a 'Risk Culture Aspects Model™' centred round the factors highlighted in Table 9 above. So while the IRM does not seek to limit risk culture to a governance and control role, it understandably adopts a strong managerial perspective, seeking to assess and control risk culture in an organised and relatively mechanistic fashion.

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Conclusions

The practitioner literature makes an important contribution to our understanding of risk culture in financial organisations, partly offsetting the slower development of academic interest in the topic. While the various pronouncements by advisors, regulators and other bodies differ in emphasis and specification of the elements that make up an organisation's risk culture, there is also considerable continuity in the approaches. In particular there is an underlying general belief that risk culture is something that can and must be assessed and managed, and that it must therefore be captured and tracked by instruments of various kinds in a structured fashion. However, our investigations reveal that there are organisations which approach the management of risk culture in more organic and less structured ways, rather than via the managerial and control orientated approaches advocated by consulting organisations and many regulatory agencies. So we conclude that one of the major critical challenges in the field of practice may be to ask whether current trends are towards a mono-risk culture which all organisations should have. If all organisations tend to adopt the same approach because they copy what they perceive to be legitimate best practice, is this desirable? And if not, what are the limits of pluralism and diversity in the cultural dimensions of risk-taking and control? No one has the answers to these questions yet.

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Risk Culture in Financial Organisations

A RESEARCH REPORT

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ISBN: 978-1909890046



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