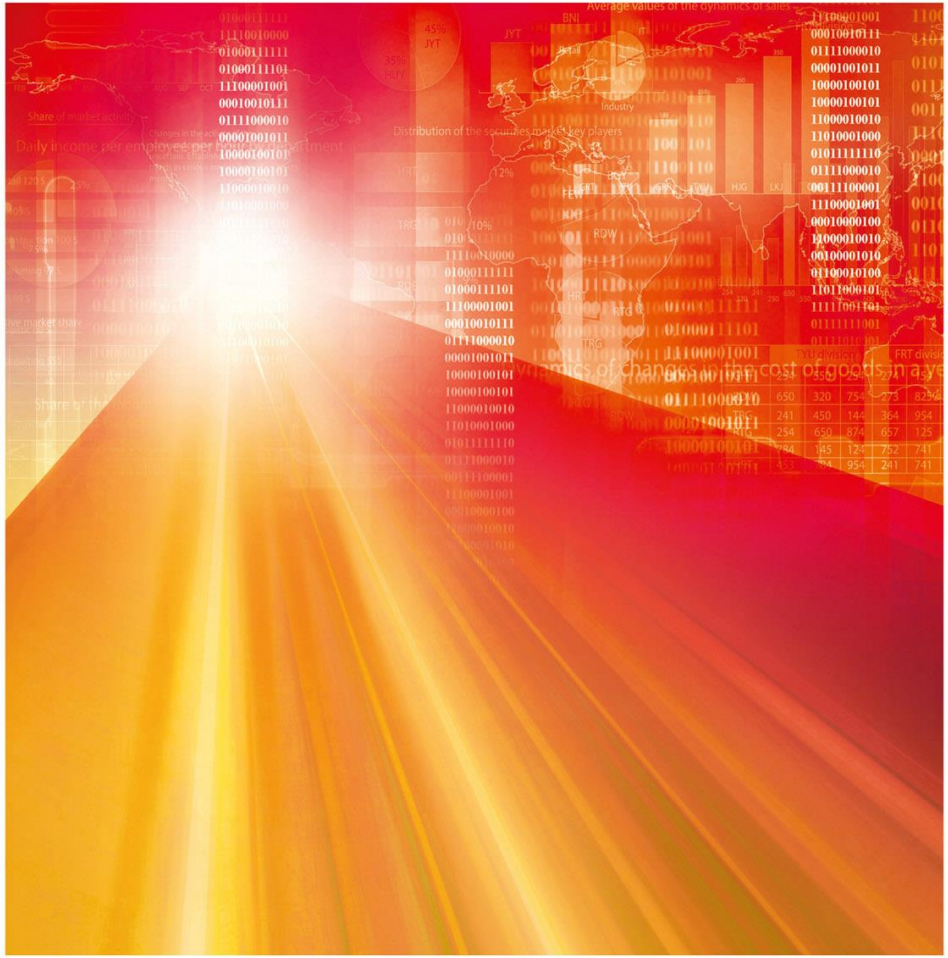
Enterprise Risk Management Seminar

Practical Risk Management

Actuaries Institute

20 September 2016 • Sydney



Enterprise Risk Management Seminar
Practical Risk Management

20 September 2016 • Sydney

Actuaries Institute

Measuring, Shaping & Predicting Risk Culture

Harry Toukalas

© Blackhall & Pearl

This presentation has been prepared for the Actuaries Institute 2016 ERM Seminar.
The Institute Council wishes it to be understood that opinions put forward herein are not necessarily those of the Institute and the Council is not responsible for those opinions.

Why are we talking about culture?

- Culture has been at the heart of many corporate failures.
- Corporate culture has become a major focus for regulators globally.
- Since the GFC conduct related issues have cost some European Banks 30% of their P&L.
- Some global regulators now require bank boards to form an opinion about the culture of the bank.

Risk Culture Profile

- **Risk Culture –** No existence of a separate "Risk Culture" – It is still organisational culture and the way this impacts on the management of risk. Therefore:

  Those aspects of the organisation's culture that influence its management of risk.

- **Good vs Bad Culture –** Labelling culture good/bad is too simplistic and binary for something as multifaceted as organisational culture. Better to focus on ***aligning*** expected and enacted culture:

  i. **Defining** and determining the expected corporate culture in line with factors such as strategy, values, risk appetite, incentives, codes of conduct and consequences;

  ii. **Measuring** and predicting the culture people are actually living and enacting at the organisational, team and individual level; and

  iii. **Shaping** and ingraining the expected culture people should be living and enacting (where gaps between values and actions exist).

Issues with Current Approaches

Culture Correlation

- There is an accepted correlation between people's values and actions.
- People feel rewarded/satisfied when they behave in a way that correlates to their important values.

Problem

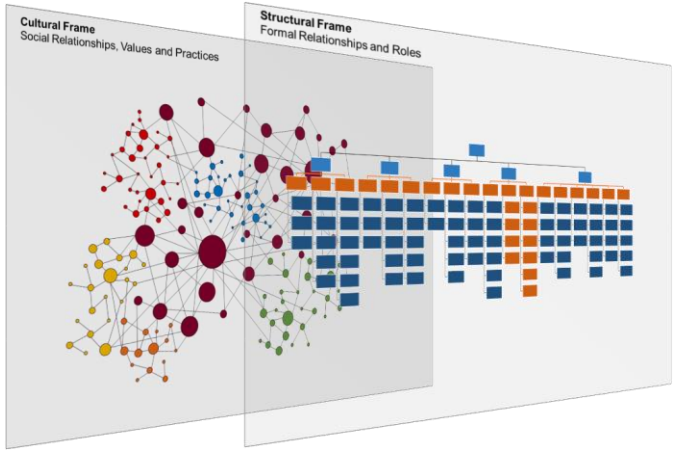
- BUT - People do not always act in line with their values (we don't always practice what we preach).
- Despite holding strong values, people's behaviour often changes depending on circumstances.
- This is known as the **Value – Action Gap.**
- The Value – Action Gap can create a disconnect between:
    - **Diagnosing Culture Issues –** what people say in surveys, interviews, workshops and training about their behaviour.
    - **Influencing Actual Behaviour –** what people do in practice given their environment and context.

Driving Behaviour

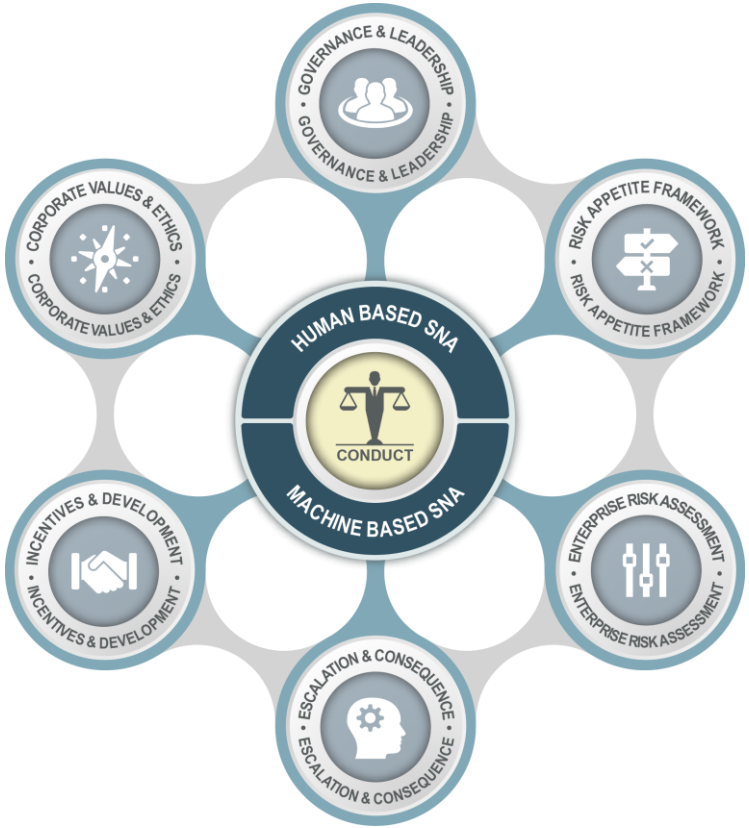
- Whilst leadership, values, appetite, incentives, consequences and training are important factors, risk culture is also a local construct.
- It is driven by social factors, which means people are influenced by the colleagues they interact with every day.
- Social Network Analysis enables us to reveal the hidden Culture Carriers within organisations – the ones who influence behaviour at the local level.
- **Scientific Basis:** Social Learning and Behavioural Economics.

Social Network Analysis

- **Social Network Analysis (SNA)** is like an organisational X-Ray – it reveals the invisible networks that have the most influence on culture at the local level.
- The formal organisational structure reflects authority, accountability, budgeting, policies, reporting, etc.
- The social network structure is how everyday work is actually done.



Integrated Risk Culture Model



Integrated Risk Culture Model

Human SNA:

- Online survey that identifies current behavioural norms and expectations related to culture and uncovers the hidden Culture Carriers who influence conduct at the local level.
- This provides an understanding of values and beliefs and enables the incentivisation of Culture Carriers to rapidly and durably change the behaviour of peers.

Machine SNA:

- Reinforces Human SNA and involves the analysis of language patterns in internal data (such as email archives and meeting logs) and external data (such as Tweets and Blogs).
- The algorithmic analysis of the way people convey their thoughts and actions in language enables the prediction of risk behaviour and conduct. Based on AI tool developed with Massachusetts Institute of Technology (MIT).

Risk Culture Indicators

Human SNA

- The type of risk culture and individual conduct evolving throughout the organisation.
- The likelihood and level of adhesion of behavioural change amongst individuals.
- The level of effective risk management by teams and individuals.
- The level of risk challenging and issue escalation empowerment.

Machine SNA

- The level of employee motivation and engagement on risk issues.
- The level of internal stakeholder satisfaction with risk management.
- The level of external stakeholder satisfaction with risk reputation.
- The likelihood of individual employee misconduct.