



Virtue, hubris and risk culture

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Reports on the larger financial failures of recent times (of which we have referred to HIH, NAB and the Equitable) invariably blame poor culture and dominant personalities, which we interpret largely as a failure of virtue – not of formal risk management processes.



An Ethical perspective

“All scandals refer to misrepresentation and concealment ... Something is hidden, or repressed from consciousness, and when it is revealed, for whatever reasons, a mechanism of blame sets off. The blame structure and the distribution of liabilities point to the ethical potentials ...
(Kyrstis, 2012)



Some Reasons Why Organisations Cause Harm

- Diffusion and Fragmentation
 - Of information - info can be available but "unassembled"
 - Of responsibility
- Harm is abstract
 - May be no tangible victims
 - Other values/goals are tangible and may compete (eg. sales forecasts vs. product safety)
 - Espoused ethics vs. "what really matters"
- Ethical issues are often complex, and emerge over time
- Corporate socialisation of unethical practice
 - "everybody else does it"

Darley 2005



Complex adaptive systems

“Business & other human endeavours are also systems. They, too are bound by invisible fabrics of interrelated actions, which often take years to fully play out their effects on each other. Since we are part of that lacework ourselves, it’s doubly hard to see the whole pattern of change. Instead we tend to focus on isolated parts of the system, and wonder why our deepest problems never seem to get solved.
(Senge, cited Waddock, 2006)”



Governance

“the set of instruments and institutions and therefore of cultures that are suited to strike a balance of powers so that none of the actors may prevail on the other and prevail especially in the sense that its opportunist interests may become the prevalent interests in the firm.” (*Sapelli, 2013*)



Dominant personalities: problem

"A cause for serious concern arises from the group's **corporate culture**. By 'corporate culture' I mean the charisma or personality—sometimes overt but often unstated—that guides the decision-making process at all levels of an organisation. In the case of HIH, the culture that developed was inimical to sound management practices. It resulted in decision making that fell well short of the required standards.

The problematic aspects of the corporate culture of HIH—which led directly to the poor decision making—can be summarised succinctly. There was blind faith in a leadership that was ill-equipped for the task. There was insufficient ability and independence of mind in and associated with the organisation to see what had to be done and what had to be stopped or avoided. Risks were not properly identified and managed. Unpleasant information was hidden, filtered or sanitised. And there was a lack of sceptical questioning and analysis when and where it mattered."

(Justice Owen, HIH Royal Commission)



Dominant personalities: alternative

“The only thing that can offset a strong personality is another strong personality. And in fact, the presence of multiple strong personalities can be an indicator of a robust risk culture. The strong personalities will, for example, promote a healthy challenge process.” (IAA, 2014)

“Leadership is not just a set of learned skills, a series of outcomes, a career, a profession, or a title. Leadership, at its core, is about character: specifically, a character attuned to its ethical responsibilities to others. The kind of character that, in regard to others, always tries to do the right thing, for the right reason, on purpose.” (Gini and Green, 2013)



Management Remuneration

“No matter how strenuously agency theorists may insist that theirs is only a positive theory of the firm, and thus entails no value judgments, the fact is that the basic approach has as its foundation a normative theory of practical rationality, one that categorizes certain forms of action as rational and certain other forms as irrational. The fact that moral rules (or cooperation) get consistently categorized within such models as irrational, and opportunism (or defection) as rational, might easily lead more impressionable minds to the conclusion that they should learn to ignore moral constraints ...”

“Thus, it would be no surprise to discover that a social environment in which the dominant assumption is that “it’s every man for himself” is one that would not only encourage unethical behavior, but could become positively criminogenic.” (Heath, 2010)



Earnings Management

A touchstone of integrity:

“CFOs feel that most earnings misrepresentation occurs in an attempt to influence stock price, because of outside and inside pressure to hit earnings benchmarks, and to avoid adverse compensation and career consequences for senior executives.”

(Dichev et al 2013)



Mechanistic worldviews?

“The most important one is that you do not want operators to be rule-following automatons as a result of a tough regime of regulatory enforcement. You want them to be thinking systemically as team players about problem prevention, not about protecting their backside against a prosecution.” (Braithwaite and Drahos, 2002)

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BASIC ETHICAL THEORIES

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DEONTOLOGY

Actions are right in and of themselves

- DIVINE COMMAND THEORY
 - Actions are right if God commands them
- Immanuel Kant (1724 –1804)



TELEOLOGY

Actions are right because they achieve the purpose of the agent

- NATURALISM - Actions are right as they align with the natural order of the world
- Aristotle (384–322 BC)



CONSEQUENTIALISM

Actions are right because of their consequences (i.e. the end justifies the means)

- UTILITARIANISM - Actions are right if they achieve the greatest good for the greatest number
- Jeremy Bentham (1748–1832)
- John Stuart Mill (1806–1873)
 - Peter Singer (1946–)



ACTION ETHICS VS AGENT ETHICS

thinking about doing



thinking about being



EMOTIVISM

Right living is an expression of the emotions, rather than of rationality

- Charles Stevenson (1908–1979) / POSITIVIST EMOTIVISM



INTUITIONISM

Right living is instinctive (i.e. morality is universally accessible)

- W. D. Ross (1877–1971)

VIRTUE

Right living is derived from the moral character of the agent

- Aristotle (384–322 BC)
- STOICISM
- G.E.M. Anscombe (1919–2001)
- Alasdair MacIntyre (1929–)
- Stanley Hauerwas (1940–)



Virtue theory

"No really rational being could understand fully what a quality like courage, temperance, justice or compassion is and yet fail to want to possess it.

From this point of view, since the virtues are not innate but entail both proper habit-formation and the development of reason, it is clear that it is squarely within the responsibility of all concerned with the socialisation and education of children – parents, teachers and others – to ensure that such habituation and instruction takes place." (Carr, D. 199, *Educating the Virtues*, Routledge)



Matching risk management requirements with their corresponding virtues

Meet obligations to all stakeholders	Justice
Disclose risks to stakeholders	Integrity
Be aware of unknowns	Humility
Ensure that no personalities become too dominant	Courage
Be diligent in considering potential problems	Self-control
Keep a sense of proportionality	Judgement



Over-complex financial modelling

“The dog and the frisbee” Haldane & Madouros

Simpler Basel I models would have worked better than Basel II models in the GFC.



Application

Analysis of surplus to highlight
manipulation of account

Reducing dominance

Changing behaviour



Embedding ethical behaviour





Conclusion

As Kyrtsis (2012, p50) reminds us,

"tendencies toward segregation between the world of regulators and the world of the regulated can undermine ongoing trust relations, and further reduce the effectiveness of informal mechanisms of cooperation."

With this in mind, we have sought to move 'beyond regulation' and back to the essence of good risk management. In this paper we have suggested that risk culture should be reimagined as a matter of integrity and a steadfast opposition to hubris and narcissistic traits. If it is indeed a matter of integrity, justice, diligence and prudence, we suggest that the development of detailed rules has long been known as a very poor way to develop these virtues. Indeed it displays certain hubris on the part of regulators that they should even try.