



Natural Selection

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Leadership & Risk Culture - Psychology & Behaviour an Actuarial perspective



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Pop Quiz

When you have been through a transformational change in an organisation, where has your organisation focused its attention:

- **A.** Structural evolution – transforming processes, systems, structures and planning cycles that enhance ways of working and better enable the organisation's aspirations
- **B.** Social evolution – transforming communication channels and forums to enable better dialogue and respectful challenging of ideas across the organisation, to leverage innovation and creativity
- **C.** Individual evolution – building deeper awareness and insight at an individual level to increase responsibility, accountability and capacity to be responsive and adaptive
- **D.** A combination of two of the above
- **E.** All three – structural, social and individual evolution

Pop Quiz

How successful was the cultural transformation?

From your answer above, were there any missing ingredients and what was the consequence of this?

Conclusion

From the interviews and case studies we have conducted across a wide range of organisations and our own experiences working with culture, we believe that engaging all **three** (a, b and c) is the only viable option to be able to achieve sustainable cultural evolution.

How culture works

Inputs : Purpose, Vision, Mission, Values, Strategy



Outcomes : Societal, Industry, Organisational, Collective, Individual

Relevance to risk culture

Risk culture - the degree to which its culture encourages or limits the taking of risks and the opportunities that arise from those risks.

Risk culture is shaped by individual evolution, social evolution and structural evolution.

If any of these are missing, the culture is like a three legged stool with a missing leg – it will fall over



Risk Culture and Financial Services

*“History never repeats
I tell myself before I go to sleep
Don't say the words you might regret
I've lost before you know I can't forget.”*

N. Finn, Split Enz song History never repeats, 1981

Conduct risk – how well have we served our customers?

- High upfront commission - surrender and re-issue
- Unrealistic illustrations of policyholder benefits
- Claims definition proliferation - harder to assess value
- Policy claims exclusions not obvious
- Policies with very low loss ratios

Conduct risk - how well have we served our customers? ... continued

- Rejecting subjective claims
- Unit trust products with switching arrangements with guarantees
- Companies with “independent” advisers that sell a significant proportion of product produced by their producer-owner
- Advising clients to transfer from defined benefit to accumulation
- Selling product with highest commission

Our observations of the past 30 years

1. Independence doesn't exist as we have perceived it
2. Individual ethics are critical
3. Structures, processes and systems intended to drive good outcomes can actually do the opposite
4. Incentives have created conflict

Our observations of the past 30 years

5. Failure of organisations is largely due to failure of leadership
6. Unconscious biases and exploitation of known behavioural biases in finance lead to less fair outcomes
7. Financial Services organisations need to implement a culture model as their core modus operandi

Discussion – Q & A #1

- Conduct risks - how well have we served
 - Would you think more deeply now?
 - Would you make the same product recommendations?
 - Why / why not?
- Observations of the past 30 years
 - Which of these 7 observations do you agree with?
 - Which of these 7 observations do you disagree with?
- Other comments, questions?

Gaps in traditional Risk Culture initiatives #1

| Risk Culture initiatives | When this is effective | When this is ineffective or detrimental | Mitigation / Improvement Required |
|--|--|---|--|
| Train & educate for awareness, skills, knowledge, ethical behaviour | Increase awareness Set clear expectations Improves knowledge | Complexity and hard decisions Can create complacency Outdated quickly | Identify unconscious biases, cognitive limitations and consequent risks |
| Additional internal risk or compliance roles | Symbolic importance of risk management Greater oversight | Outsource responsibility for risk to the compliance team Don't see risk as my role Quality vs quantity of resources | Partnership between risk and business Responsibility mindset and awareness of how behaviours influence others, impact on culture. |
| Risk culture assessment | Openness to feedback Identifying gaps External perspective | Limited scope Only measures outputs rather than root cause | Culture of learning and feedback Forward looking indicators / warning signals |
| Leader role modelling (lead by example) | Highly respected leaders Role modelling is genuine Tone from the top AND Tune from the middle | Role modelling is not consistent Cultures / individuals that aren't influenced by leadership | Zero tolerance for senior leadership inappropriate risk behaviours Authority to hold individuals accountable, set strong boundaries |
| Communication | Focus on success Focus on learnings Regular reinforcement | When not aligned with reality (often just focus on positives) can create cynicism | Realistic and optimistic- share the challenges honestly AND share the progress. Acknowledge appropriate risk behaviours |

Gaps in traditional Risk Culture initiatives #2

| Risk Culture initiatives | When this is effective | When this is ineffective or detrimental | Mitigation / Improvement Required |
|---|--|--|---|
| Independent reviews | When truly independent Fresh pair of eyes can identify blindspots | Not truly independent / reviewer is subject to influence of reviewee / dilutes message Can only go so deep | Independent body (e.g. regulator) assign independent reviewer Roles with dual reporting lines – to regulator and to organisation |
| Internal Control Registers | Provides internal authority Genuine independence of person signing off - Internal Control Registers | Seen as a tick the box Pressure to sign off Focus only on my patch; narrows thinking | Include regular "risk deep dives" Consider systemic risks and consequences of your actions for other areas |
| Recruit for desired risk behaviours | Increases awareness of risk culture focus Builds right capability | Past experience is not always indicator of future behaviour | Recruit based on mindsets and values as well as experiences / behavioural attributes |
| Incentives / punishments | Identify behaviours and outcomes that organisation really values | Punishments not enforced Conflicting incentives Unintended consequences Incentivises self interested behaviours | Rethink incentives! Zero tolerance for obviously bad behaviour Symbolically remove 'rogues' |
| Include risk as part of strategy sessions | Signal that risk is also about opportunity Encourages enterprise approach | If risk is rubber stamped / glossed over | Include a 'risk advocate' in strategic conversations, NOT someone from the risk function Mindset that risk creates opportunity AND must be managed effectively |

What stage of Risk maturity is required?

| Maturity level→ Item | Unaware | Reactive | Mechanical | Pro-active | Mature risk culture |
|---------------------------------|---|---|--|---|---|
| Beliefs / mindsets | Risk management is just a concept | Risk management received with cynicism, a management whim | Importance of risk management accepted | Actively aware of and owns risk as part of work | Risk = opportunity |
| Organisational attitudes | Individuals blamed when risks eventuate | Must eliminate losses; very top down approach | Workforce more involved but with limited understanding | Workforce involvement promoted, though team leaders still take responsibility | Partnership between management and workforce; shared responsibility |
| Individual behaviours | Takes many risks without realising it, blissful ignorance | Meets minimal legal compliance reqmts; Ignores until reporting time | Day to day risks are managed effectively | Regular discussions on risks, active prioritising to manage risks | Workforce drives risk assessment, shares insights across business |
| Systems / structures | None, no communication or training | Compliance reports, detailed reviews of failures | Performance management systems. Risk dashboards | Active feedback loops, actions beyond reporting | Culture reviews. Employee perception surveys. Behaviour based training |
| Risk function | None | Compliance function. Influences through authority. | Function accepted, carries out organisation reviews, focus on improving procedures | Partnership with management, compliance at business line, influences via relationships. | Risk function co-operative and supportive as managers and teams take responsibility. Forward looking. |

Chief Risk Officer Perspective

“The Regulatory direction and the findings of the Royal Commission mean that the role of the Chief Risk Officer is quickly heading towards becoming the Chief Cultural officer”

– quote from a client in a financial services organisation

An Actuarial Perspective

- 1 Code of conduct - professionalism
- 2 Statutory requirements – prudential standards, laws, regulations

| Actuarial role | Culture & Conduct risks eg | Risk mitigation (example) |
|----------------------------|---|--|
| Appointed actuary | Not differentiating principles & practices | Defend principles. Deeply understand practices. |
| Pricing actuary | Deceptive pricing via complex cost recovery | Keep products simple |
| Marketing, sales actuaries | Limited, biased disclosure of info to consumers | Plain English honest disclosure |
| Systems & data actuary | Accessing private, but publicly available, info | Enforceable, audited, respectful use of member data |
| Board member | Not driving culture improvement | Know your leadership team and their sign offs on processes |
| Chief risk officer | Not being sufficiently vocal | Build strong influence with Board |

Taking responsibility



No single drop of water thinks it
is responsible for the flood

Discussion – Q & A #2

- How do you develop a mindset that sees culture as an ongoing evolving phenomena?
- How do you engage your organisation on the journey of ALL facets of cultural evolution?
- Your questions & comments

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