‘The Dialogue’ Podcast

Episode 2 Transcript – Social Risks

Date: 19 Feb 2018
Interviewer: Rick Shaw
Guest: Ian Laughlin
Duration: 21:05 min

TRANSCRIPT

Rick: Welcome to our Actuaries Institute dialogue podcast. I'm Rick Shaw. I'm a partner of Deloitte and a fellow of the Institute. This podcast aims to give you an overview of the actuaries thought leadership series ‘The Dialogue’ leading the conversation. The Dialogue papers cover a wide range of topical issues from genetics and life insurance to health insurance affordability, and today we're talking about Social Risks for a financial services business.

This is a hot topic with the Royal Commission having just kicked off in the banks and insurers facing intense community and government scrutiny. In his paper, Ian asks why with all the money, resources and intellect they spend on managing risk. Why are institutions still being castigated by the press, politicians and social media for unacceptable attitudes and behaviour? Are attitudes changing in society? Are our institutions keeping up with changing attitudes? What do we do about fake news?

To help us explore these fascinating questions we welcome Ian Laughlin. Thanks for joining us Ian

Ian: Thanks very much Rick, it’s good to be here.

Rick: Ian, in your paper, you make reference to something of a failure of risk management. Why do you think that risk management has failed?

Ian: That is a really good place to start because if you sat down with say the CEOs of the major institutions say ten years ago and said this is what could be like in 2016, 2017 and 2018 with parliamentary inquiries, CEO’s being interviewed by those parliamentary committees, multiple investigations by ASIC, TV reviews of performance of life insurance claims etc, if you have proposed to them then that this is what it might be like, they probably would have said “it couldn't happen“ and one of the reasons they would’ve said it couldn’t happen is because they manage risks in their business and they have appropriate resources, time commitment and so on to managing those risks and yet you can easily mount an argument now that risk management has completely failed those institutions because look at where they've actually found themselves, not just the major institutions but the industry itself.

So, my starting point was sitting there saying how on earth could this have happened and that led me to think about changes in society and attitudes and behaviours in society and so I started to delve into this a little more deeply and from that came this paper and the idea of social risks for financial services businesses.

Rick: Let's define some terms here Ian. You talk about risk management. One of the things you do which I think is quite valuable in your paper, is delve into a set of risks that even if they were around ten to fifteen years ago were not as a vocal as they are now. This is the social risks that you talk about. You're dividing it into internal social risks where we talk about cynicism risk of staff, patronism risk, self-awareness risk and so on, and then looking at the external social risk is very useful, but what I wonder is if you feel that these risks are ones that come about from a generational change, where the people coming through now, the so-called "Millennials", are a little more sceptical about our corporations?

Ian: Oh, I think that's true. What we're seeing now are significant changes in social attitudes. That's partly generational but not exclusively. Part of what I'm arguing is that those changes in social attitudes are a function of the new world in which we operate. The new world includes access to huge amounts of information, communicate in ways that are unheard of before such as the use of Twitter, the use of facilities like Facebook to spread an opinion, capabilities like phones, everybody's got a phone in their pocket and so things that might have escaped scrutiny in the past, don't escape scrutiny anymore.

Individual consumers have in effect become vastly more powerful than was the case in the past. 20 years ago, behaviours in the financial services industry, I would venture to say were not as good as they are today, but attitudes have changed, tolerances have changed in society and poor behaviour is being called out. So yes, it is partly the generational change, but I'm quite sure that people even of the baby boomer generation have different attitudes now to what they had twenty or thirty years ago. Their tolerance levels for poor behaviour are much lower and their ability to call those issues out is much greater.

Rick: So we have a different risk profile, now I'm wondering about our management of risk, whether we need to refine or do something more drastic to manage the changing risk profile. Do we have the existing frameworks and the existing institutional culture to allow us to respond to generational changing and attitudes towards government and large institutions or is something more radical needed?

Ian: In theory there's no reason why you can't apply the same sort of risk management techniques to social risks that you can apply to any other risks. So you would do identify them or assess them. You mitigate them as you see fit, when you eliminate them you report on them that you monitor and so on. So social risks can be addressed in exactly the same way. My argument is that institutions have failed probably in all steps of that process, starting with identification so there's not an understanding of what those social risks are, organisations haven't formally identified them as risks. They haven't therefore done anything about them and consequently they've paid the price.

So, the starting point is you have to recognize these risks are there. You then have to have capabilities to manage those risks with all that entails as a second identification etc so the starting point I think has to be handy you actually identify these social risks and assess their implications for the business.

In the paper I then go on to the idea of what I call 'risk sensing' where you have forward-looking sensors to understand what's happening in society.

Our attitudes and behaviours are changing but importantly looking forward for the implications of that, not looking backwards and so often in risk management, you know conventional risk management, the risks are monitored it in arrears. That key risk indicator is very often when you look at them what organizations are using this key risk indicators, they had backward-looking measures and that simply can't work with something like social risk. So, you have to have the capability to understand what's happening out there in society. Changes in attitudes and so on but then really importantly, understand what that might mean for your business in the future.

Rick: That sounds very sensible given the framework that we're in at the moment. Let me just ask, we have this royal commission going on at the moment, which is a lot to do with the behaviour of our institutions, and I'll use the CommInsure life claims as an example. I would say that looking externally, CommInsure would have had a risk management framework and would have had in their risk management framework, a risk appetite statement and I assume would have been making some reference to brand value and so on, so we had a management structure in place and I wonder if the frameworks in which we're doing this with handling risk management is capable of evolving into something that is forward sensing as you're suggesting?

Ian: Look there's no reason why it can't. The starting point has to be an understanding that backward-looking measures aren't very helpful, so put aside social risk for a minute and let's just talk about risk management generally. You really do need indicators that keep you in touch with what's happening at the present time and where it's going and that doesn't mean looking backwards and perhaps assessing a trend, because the trend may only give you some indication of how it might evolve into in the future. In any sort of risk what you want to be doing is understanding what's happening at the moment, understanding the trends and understanding how it might evolve in the future and the implications then for the business as it changes. If you then extend that basic principle to social risks, the question is what sort of risk sensors should you actually have? The answer to that question is not really clear, because this is sort of an evolving field and it's not obvious that expertise is available technologically with people or in any other way.

I get part of my argument of the paper is that organizations need to develop these capabilities. There are no shortages of organizations out there that will tell you that they'll be up the monitor what's happening on social media for you and so on but to truly understand what's happening because as we as we know, you can get a lot of misleading information and ideas on social media. To truly understand what's happening and what the implications are for the business, you need really deep insights and I don't think organisations have that, those deep insights at the moment or even the capabilities to get those deep insights and it's not clear where you might get those capabilities. So, there you have a bit of a conundrum. How does the industry develop these capabilities that properly assesses and manages these risks and so you don't end up in the sort of situation that we're in now.

Rick: I think just to explore that a little further we'll use what I think is the greatest failure we've had in recent times in this country of a trust of an institution, which is the Royal Commission into the churches and other institutions. Now if I think of the churches, what we had, it seemed to me was an alignment of senior figures with the constructs of their

institution, what you call the 'patronism risk', where the focus was on what is best for the church rather than what is best for the people.

Ian: Yes, so what I tried to do in the paper was to break social risks down into various types and I don't pretend that the classification that I've used is perfect or complete but it helps understand the concept of social risks. So, one of the classifications is cynicism risk and that is the risk where an organisation cynically does the wrong thing basically, because it believes it's in its own interests for that to occur and so the example I give in the paper is of tobacco companies and in particular tobacco companies promoting smoking to children in third-world countries. So that's a cynical approach to doing business.

Patronism risk was another one as you mentioned and that's more about saying *"we know best. You as a society don't need to know too much about this. We, the institution know best. We'll manage this. We won't necessarily tell you what's going on"* and so on, and there are other classifications of risks that might be relevant in the case that you cite. As you mentioned I broke the risks down into what I called internal social risks and external social risks.

Internal social risks are those that are a function of awareness knowledge and understanding attitudes and behaviours of board and management. So, they are a function of things that fit broadly within the control of the organization, but having said that you can't just easily obtain that awareness and understanding that is needed to address internal risks.

External social risks are not so much within the control of the organization, that they're what's happening in society at large but the institution, the organization needs to have a deep understanding of what is happening out in society, not so that they can necessarily change society but so that they can adapt the way they're managing their business to minimize or eliminate any risk to that business. They need to be addressed separately and with a different mindset.

Rick: I think there's also possibility of some overlap in the tangible actions to address these forward-looking risk. I wonder if what we have with a lot of risk management frameworks is it comes from a command-and-control culture within our corporations where a framework of risk is disseminated down to the workers. I wonder and I think the Catholic Church is a good example, if that approach inevitably leads to some alignment of personal value or some replacement of personal values with corporate values and you're looking forward, your risk sensing of encouraging empowering people to (within a framework) bring out their better selves?

Ian: So you're on to a broader issue here which I deliberately avoided in the paper and that is cultural risk within an organization but let me just touch on it briefly because it is relevant. I mentioned values risk in the paper. Values risk is where the values of the organization, the espoused values, this is the way we want to operate and believe and so on. The espoused values are out of step with the attitudes of society. Now not many organizations will suffer from that but some will.

The bigger issue is what I call true values risk and that is where the real values in the organization differ from the espoused values and a behaviour which flows from the values are out of step therefore with what the company supposedly wants is certainly what the community expects, so that then leads to the idea of culture.

So if you have an inappropriate culture now, we're going well beyond social works but if you have an inappropriate culture with remuneration drivers that don't support the espoused values then inevitably the organization will end up with some problems and some difficulties. One of the challenges with social risks is to ensure you have an appropriate culture and that's a topic in its own right, but having an appropriate culture will certainly help you address social risks.

Rick: I was captured by your concept of risk velocity, why damage to a business seems to be able to happen so quickly now. I just wondered if you could expand on that concept of risk velocity?

Ian: So the risk velocity is more or less the speed at which the risk has an impact and we all know pace of change in the world has increased quite significantly it doesn't matter what you're talking about but technology has been at the root of much of that change and the speed of change and part of what I'm arguing here is that social risks have high risk velocity so if you take the sexual harassment issue that's emerged over the last few months, well look at how quickly that has had an impact. It merged from basically nothing, probably within the last six months and yet you've seen multiple high profile people damaged, probably irretrievably damaged in terms of their reputation.

You've seen companies get themselves into great difficulty. You've seen companies come out and make statements about changes in their values, changes in the way they're going to monitor relationships between more powerful people and less powerful people and so on and so forth. That's happened really, really, quickly.

Allied with the idea of risk velocity, I used the term risk momentum and I was trying to capture the idea that some of these risks are not independent and once one starts to run, the other might be there and it'll multiply the impact of the first one and a good example of that is political risk, but what did I actually call it? I called it political opportunism risk and that's where it suits the political or the politicians to jump on a bandwagon so accusations are may not even necessarily be completely accurate but accusations made for example by a TV documentary may cause immediate damage from a reputational point of view to an organization so they have an impact in their own right and they may be justified, they might not be but they'll have an impact and then the politicians decide it's in their interests to jump on that bandwagon and so, on the nightly news instead of there just being a documentary you then have senior politicians building the story, adding momentum and so on, so you get this idea of risk momentum and the combination of the weight of those risks and velocity delivers momentum.

These sort of risks, I argue have higher risk velocity and high risk momentum.

Rick: One last question Ian, on the increasing role of automation algorithms in our large institutions, where these algorithms are such that the people who build the algorithms are continuously updated and so the people who build the algorithms may not be aware of where they're going and I wonder what you think about board. How does a board or senior management take responsibility for the output of automatic systems?

Ian: Since I wrote the first draft of this paper you've had Facebook come out and say we need to fix what Facebook is doing.

Even in the last couple of days you've had the FBI come out and confirm that there were Russians using social media, I think Facebook and Instagram were mentioned, to at least disrupt thinking in the American community, maybe influence the outcomes of an election.

Now I don't know exactly how they did that, but they've clearly worked how the algorithms work and they've started to use them to their advantage and one of the issues it appears is that algorithms can be soft feeding and so if you express an interest in a particular topic and then some false statement, some fake news, genuine fake news is posted, you may have that fed to you on your social media. You in turn might think "well that's very interesting" and you pass it on to other people and so by showing an interest in on topic you get fed automatically that false news about that topic and the system is such that it gets spread and the more outrageous the false news is, the fake news is, often the faster it will actually spread.

So instead of social media being a conduit for accurate reporting in news, it's a conduit for fake news. Now I want to distinguish between fake news and what I call reverse fake news, so fake news is where it's genuinely incorrect but it's propagated through social media and so as I've just described. Reverse fake news is where you actually have a true story but it is dismissed with statements that it's fake news.

So reverse fake news is saying that something is fake news when in fact it's not fake news, it's factual and correct news, and so you see that in American politics at the moment.

Rick: We've run out of time Ian, I've found this very interesting and I've enjoyed this conversation with you and I just wondered if you've got any final comments?

Ian: Look I think if this idea is embraced then the financial services industries have a lot of work to do in this whole area and it's non-trivial work. It's not even clear to me the best way to actually tackle it but for institutions to ignore social risk, I think is absolutely folly and you can see that with the results that we've got today with the Royal Commission.

Rick: I just like to thank you Ian for contributing the paper which I found very interesting and for taking the time to join us here today. So I'd just like to wrap there by saying look out for further articles about risk for financial business on actuaries.digital and get in touch with us at the actuaries@actuaries.asn.au with comments on today's conversation and there are others so look out for episodes and papers in our dialogue thought leadership series and head to the public policy and media section of our website for more of the latest research from the actuaries I'm Rick Shaw, bye for now.