Changing social attitudes mean financial institutions need new risk approach

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Conventional risk management may be failing Australia's financial institutions, which have been subjected to scorching community and government criticism, tougher regulations, and now a Royal Commission.

In a Dialogue Paper* *Social Risks - for a financial services business*, issued by the Actuaries Institute, author Ian Laughlin, said institutions do not seem to be effectively managing the risks that come from swiftly changing social norms and attitudes. Mr Laughlin has extensive experience in senior management, on boards and as a regulator in the financial services sector.

He has questioned whether "conventional risk management is working as it should in the contemporary world."

"How can it be that institutions spend huge amounts of money, resources and intellect on managing risk, and still find themselves being castigated by the press, politicians and social media for unacceptable attitudes and behaviour?" he said.

"The government has freely criticised the banks, subjected them to intense parliamentary scrutiny, and has announced its intention to impose new law on accountability and remuneration. And now after much political battle, there is to be a Royal Commission into misconduct in the banking, superannuation and financial services industry."

He argues that companies seem to lack the capability to understand and manage the risks that flow from rapidly changing social norms and attitudes.

While poor standards and behaviour by organisations are often the direct cause of this unrest, he argues that standards in some areas are actually higher than they were in the past.

What has changed is the community has stepped up in two ways: society's expectations are rightfully much higher and tolerance for egregious practices is much lower than they once were. And, society's ability to see and to call out unacceptable practices and to highlight poor outcomes has become much more powerful via Twitter, Facebook and other social media platforms.

It may be that "institutions have not managed the risks that come from changing social attitudes and norms and the power of new social capabilities. Such risks need a fresh approach." These are social risks, he said.

The factors that fuel social risks include ready access to information and social media in particular. At the same time, there is something of a paradox: more information, but also more wrong information that spreads with great speed.

To help provide insight into social risks, Mr Laughlin has produced 14 labels for types of social risk that include:

- cynicism risk; when a business consciously accepts its own poor attitudes and behaviour - for example, systematic underpayment of staff in franchise businesses.

- true values risk; when the actual values of management and staff conflict with the company's espoused values. Most companies in financial services will have suffered from the consequences of this risk, driven perhaps by culture or remuneration. An example might be sales targets for bank branch staff driving behaviour at odds with the espoused values.

- insight risk; where a business has a poor appreciation of current social norms and expectations, and the pace of change. An example of this is the life insurance industry's struggle with adequately anticipating and pricing for rising mental health claims.

- tolerance risk; society's attitudes change quickly and significantly, catching a business unawares. The recent movement against sexual harassment, which in some industries was tolerated and covered up, is an example of this.

Mr Laughlin also says fake news is a danger for Australian corporations, particularly banks, because consumers seem to have little sympathy for banks and their boards and management. There is a risk that an accusation may be blown up whether it has merit or not, the paper states. A critical article then might be fuelled by trolling from readers. "And once trust is damaged, it is very difficult to recover."

Mr Laughlin notes the difference between fake news, and what he calls reverse fake news – the latter being where correctly reported news is effectively dismissed as fake news.

While some of these risks may not be new, the pace at which they can manifest themselves is very high.

Mr Laughlin draws a distinction between internal and external social risks.

Internal social risks are a function of awareness, knowledge, understanding, attitudes and behaviour of boards, management and staff. This includes the organisation's risk culture, an area of keen interest for the Australian Prudential Regulation Authority.

External social risks are more a function of what is happening in the community and the impact of this on the business. They are harder to mitigate but still require high awareness and conscious management.

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The Dialogue paper promotes the idea of social risk sensing, and draws a distinction between this and the use of more traditional risk indicators. The latter are often backward-looking and lack an element of anticipation. Risk sensing is a much more sophisticated approach, involving sensing social risks and their possible impact in almost real time.

This in turn suggests the need for financial services businesses to have deep and effective capabilities to monitor and assess social risks. The business should have sensors feeding assessments of social attitudes and norms, and interpreting their impact on risk for the business.

Sensors could take multiple forms – for example, pulse checks of attitudes, or automated analysis of trends on social media, including the use of artificial intelligence to assess attitudes as they are expressed – but would need to be much more sensitive and relevant than current measures.

In turn this will need new and quite different resources and capabilities – technology and people – allied with a deep understanding of the business and its customers. At the heart of this might be a Social Risk Officer.

*The Dialogue is series of thought-leadership papers, written by actuaries that aim to stimulate discussion on important issues. Opinions expressed are those of the authors and not necessarily those of their employers or the Actuaries Institute. A copy of *Social Risks for a financial services business* can be downloaded here.

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