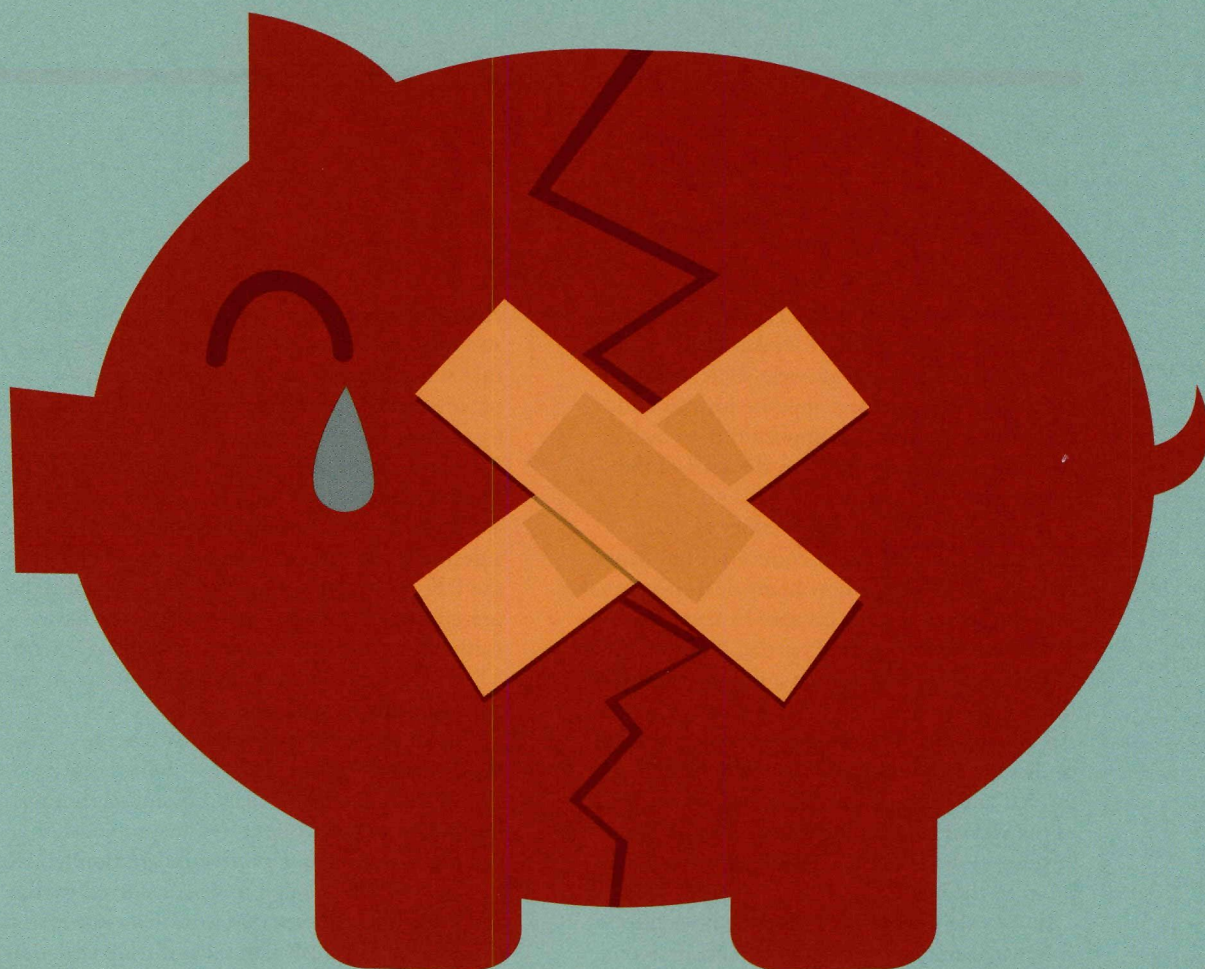




Shaping financial risk culture

L&D has an important role to play in helping banks adopt an holistic approach to risk management, says **Sarah Tennyson**

In this article, I will show how Schein's organisational culture framework can be used as a practical guide to shaping a culture of holistic risk management and share how we help clients to combine competence development and attitude change with systems and process improvements.

Financial institutions around the globe face a regulatory imperative to build an organisational culture that supports holistic risk management and sustainable risk/reward ratios. The European Banking Authority and the US and UK regulators all urge banks to measure and report on an integrated view of the different types of risk incurred in their businesses.

The UK's Prudential Regulation Authority

states that: "The boards and management of regulated firms must understand the kind of behaviour that will deliver an acceptable level of safety and soundness from the point of view of the financial system, and act accordingly. [...] And it includes embedding the principle of safety and soundness in the culture of the whole organisation. Without such effective, prudent management and governance, it is not possible for firms to ensure their own safety and soundness."¹

Investors, rating agencies, governments and the media have also focused on the impact of cognitive and social factors on risk decisions.

Aside from the external pressure, an holistic approach to risk management has obvious benefits for the institution itself, for example in lower provisioning for bad loans and more

References

- 1** Paragraph 68 of the PRA's approach to banking supervision (April 2013)
- 2** Paragraph 72 of the PRA's approach to banking supervision (April 2013)



³ Schein
E *Or-
ganizational
Culture and
Leadership*
John Wiley
& Sons
(2010)

⁴ Ibid

⁵ *An accident
waiting to
happen:
The failure
of HBOS*
chapter four
"A failure
of internal
control"
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effective allocation of scarce capital. An effective risk culture helps frontline bankers ask the right questions, listen to the answers, understand the bank's requirements and appetite for risk and, therefore, gives them an opportunity to manage and mitigate those risks from the start of the negotiation with the client.

It is easy to measure the number of deals that get declined at credit committee but banks typically do not track how many deals never make it to the approval stage because bankers have lacked the skills to gather needed information or to structure the deal in such a way that it meets the client's needs but also fits the bank's appetite. Addressing the skills, behaviours and attitudes of these teams jointly enables relationships to be formed and better quality dialogue to take place in the service of reaching sustainable, high quality business decisions that also deliver revenue and profit to the bank.

In moving towards a holistic approach to risk management, organisations must overcome ingrained ways of working, beliefs and attitudes. A process of 'unfreezing' these behaviours must take place before it is possible to effect a cultural

change. These existing behaviours are upheld and reinforced by other elements of the system that silo different types of risk, for example organisational structures, performance metrics and incentives, and software systems.

One of the challenges for those responsible for shaping the culture within financial institutions is that, to date, no criteria for what constitutes a desirable risk culture have been published. In the UK, for example, the PRA chooses not to be prescriptive: "The PRA expects firms to have a culture that supports their prudent management. The PRA does not have any 'right culture' in mind when making its assessment."²

One of the most prominent writers on organisational culture, Edgar Schein, defined culture as "a pattern of shared basic assumptions learned by a group as it solved its problems of external adaption and internal integration which has worked well enough to be considered valid, and, therefore, to be taught to new members as the correct way to perceive, think and feel in relation to those problems"³.

This definition can be usefully applied to the way that financial institutions evolve their perception and management of risk. As a practical framework for assessing culture and tackling culture change, we have found Schein's work to be useful and adaptable in helping banks approach the task of shaping a culture of holistic risk management.

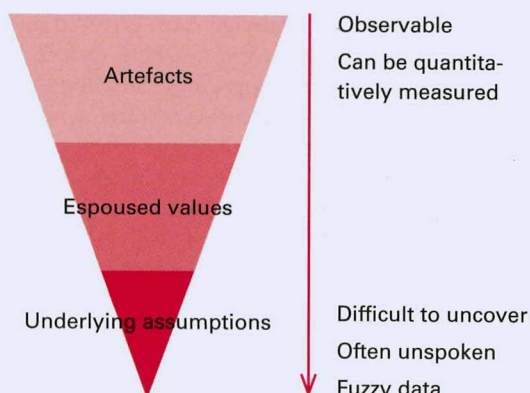
Schein argues that culture can be examined at three levels (see diagram opposite).

In order to achieve changes to the culture, individuals within the organisation must 'unlearn' existing habits before they can embed new ones. Schein describes this process as causing "learning anxiety" in individuals as challenges to their existing assumptions threaten self-identity and group membership⁴. For example, implementing a belief that 'risk is everyone's responsibility' in an organisation where there has traditionally been a strong divide between control and commercial teams requires people on both sides to shift their self-image to incorporate more of the attitude and function of the other.

Without a climate of psychological safety sufficient for people to open up and explore the barriers to change that exist at a personal or emotional level, the desired evolution in culture will not occur. For L&D and OD professionals in the financial services industry, working at this level within the organisation presents one of the greatest – and most exciting – challenges.

Applied to the risk management functions of a bank, the following are typical examples:





Artefacts

- risk policy, risk appetite framework, approval limits, approval processes, organisational structure, systems, templates/forms, physical layout, geographic diversity
- observable behaviour of employees, eg communications, committee membership, meeting attendance, tenure, attrition.

Espoused values

- published statements of corporate values, corporate and departmental mission statements, departmental goals, competency frameworks, performance and selection criteria.

Basic assumptions

- revealed in day-to-day attitudes and choices expressed through situational behaviour. For example:
- overruling decisions made according to risk policy
- strength of challenges made to business lines and senior decision makers (eg as reported by the Parliamentary Standards Commission⁵)
- influencing and persuading decision-makers outside of the formal approval process
- promoting or retaining individuals whose behaviour flouts the corporate values but whose technical capabilities or revenue-earning record are deemed to be of greater importance
- bystander effects (eg as reported in the investigation into Libor rate submissions⁶)
- investing in technology to aggregate data but not the skills to interpret the output.

For most financial institutions, the logical place to start building a risk culture is with the policies and procedures, for example reviewing (or creating) an RAF, setting approval limits, delegating authority etc. Both the PRA⁷ and the EBA⁸ see this as a core part of the risk culture. During this phase, issues of poor quality data or their lack of

ability to aggregate and report on it efficiently are recognised and create an urgent need for upgraded systems that are quickly implemented.

Building the desired culture, however, requires further work that focuses on the competence and attitude of people and the leadership within the organisation. Learning is central to this change. In a recent survey by the Institute of Risk Management, 'risk competence' was ranked among the weakest aspects of risk culture in its respondent organisations⁹.

Training programmes can be a quick win for the change initiative; many banks recognise the need to upgrade the skills and knowledge of their people to match the sophistication of their new systems. Credit skills training has measurable results: at the individual level, knowledge and skill can be easily tested; at the organisational level, quantitative metrics are available such as the number of credit applications going to appeal, the number of queries made on credit proposals and the number of times proposals are sent back to presenters. Ultimately of course, the quality of credit risk decisions is reflected in the asset quality, profit performance and level of provisioning made by the bank.

While implementing training can be seen as a quick win, the lessons learned can be quickly reversed. Culture trumps training every time, as we are reminded by the oft-told story of the enthusiastic person who attended a training course only to be told by their (older, wiser) colleague on returning to the desk that 'it all sounds good, but that's not the way we do things around here...'

Insight into the culture of the organisation can be seen even at the design stage of a training programme: on the one hand, the organisation states that it needs to improve credit skills; on the other hand, it is reluctant to put senior people through a training programme that appears too basic or to give them diagnostic tests. The underlying assumption revealed in this type of comment is that it is more important to save face and defer to senior titleholders than to ensure that everyone has the requisite level of credit skills. If an organisation holds this belief as part of its culture, it is no surprise that poor quality assets appear on the balance sheet or that deals are missed despite having an acceptable risk profile, even when staff appear to have followed the correct procedures.

In lending institutions, particular attention is being paid to the level of credit skills in credit officers and in front-office bankers as the first line of defence. Banks that stand a better chance of ensuring that both commercial and control

⁶ "That suggests something is deeply wrong with the culture that could possibly have allowed that to occur." www.publications.parliament.uk/pa/cm201213/cmselect/cmtreasy/481/48104.htm

⁷ "The PRA expects a firm's risk appetite to be integral to its strategy and the foundation of its risk management framework, so that the whole firm operates within this appetite. This requires a robust risk management framework and its effective and consistent implementation throughout the organisation." Paragraph 100 *Prudential Regulation Authority Approach to Banking Supervision* (April 2013)



- 8 EBA
Guidelines on Internal Governance (GL 44) London (September 2011)
- 9 Institute of Risk Management
Risk Culture Resources for Practitioners (October 2012)
- 10 Paragraph 100 of the PRA's approach to banking supervision (April 2013)

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functions take responsibility for risk as required by the PRA¹⁰ design interventions that address both skills and attitudes. What L&D must do is break traditional learning silos of technical vs soft skills, separated training for the three lines of defence and the different types of risk, segregated systems training vs the ability to interpret and use output.

To build a culture of holistic risk management requires an additional layer of learning focusing on meta-cognitive abilities such as reflection, critical thinking and conscious awareness of the thought process, which is different from the expert-learner paradigm dominant in technical knowledge or analytical skills courses. Financial institutions need to develop people who are able to recognise and address difficult, uncomfortable or intangible issues arising during their daily work. In so many reports on bank failures and crises, the investigation revealed individuals who had a strong sense that something was wrong. What they did as a result of that sense differs among individuals, yet common to all the cases is that they were (or felt) so disempowered that the warning signs and control functions they represented were unable to prevent the crisis unfolding.

Training that is implemented in support of a holistic risk culture must be designed to give people the awareness and ability to acknowledge and act on that sense and discuss the 'un-discussables'. When a critical mass of people have developed in this way, new behavioural norms emerge, bringing the culture closer to an holistic approach to risk at all levels of the organisation.

In terms of learning objectives, therefore, the following are required in addition to developing a sound technical knowledge of all the different types of risk:

- build awareness and appreciation of an holistic risk management
- ability to reflect, question and challenge the way you analyse risks
- confidence and ability to articulate, challenge and question other stakeholders in the bank about their perception of integrated risks.

The design of the learning intervention, therefore, must include facilitated discussions that help participants develop this reflective awareness of their approach to the task in hand. During case studies, the technical debrief can be combined with questions and challenges on the way that the participants were thinking about the particular scenario, or about their own situations/

challenges at work. The design must be based on continuous learning opportunities, both formal and on-the-job, and managers must be willing and able to coach people. Little and often will be more effective than intense one-time courses.

A secondary objective for many banks is to enable people to communicate and share the desired culture with colleagues. This does not mean being able to reel off a statement or a set of values. Communicating the culture is about everything you do and say that aligns or undermines the culture you are trying to create. This is where the assumptions underpinning the culture, versus personal assumptions, come into play. For example, what you pay attention to, what questions you ask, what stories you tell/repeat and what emotions are attached to those stories (eg admiration, disbelief, anger, disappointment, etc). Storytelling can be a powerful means to reveal these assumptions and challenge them. Banks should insist that credit officers and client relationship managers attend training together and support managers in reducing the cultural antagonism created by using 'them' and 'us' language.

L&D and OD play an important role in moving the organisation towards a holistic risk management approach, in terms of implementing new learning methodologies and training designs and aligning the other parts of the organisational system, such as performance management, reward, selection and talent management, with the desired culture. Creating new ways of approaching daily work with a wider appreciation of how different types of risk integrate, it is necessary to offer a more holistic approach to how we learn and develop. It will take time – the expert-novice model that dominates technical training is not effective at unfreezing the old, and refreezing the new, attitudes and behaviours that is required.

In organisations with the greatest chance of success, we see ownership and accountability for culture change at the executive and board levels. People from across the organisation can clearly articulate the burning need that is forcing change in their organisation. People are confronted with their competence, behaviour and beliefs no matter where they sit in the organisation. We have worked with banks who have changed their artefacts and restated their espoused values, implemented diagnostic testing and knowledge training on domain-specific and integrated risk management, and actively support people in translating this into application and behavioural change at the front line. **TJ**

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