Risk culture
How can you create a sound risk culture?
Why now?

Concerns about risk culture have arisen from the risk taking pre-crisis and even more from the disclosures of conduct failures globally. This has led to a focus from boards and a new level of scrutiny by different types of stakeholders such as shareholders, customers, investors, rating agencies and regulators. The enhanced regulatory focus is underlined by papers from the Financial Stability Board ('FSB') and by changes in approach of many national regulators. To answer this new level of scrutiny, we are now seeing a range of financial institutions invest in culture-related programmes.

- Financial institutions are defining what their current risk culture is and are understanding how culture and behaviours can be effectively managed and changed in a pragmatic, demonstrable way;
- The focus is no longer only on ‘tone from the top’, but also on how behaviours and values are embedded in the daily behaviours and decision making processes throughout the organisation;
- The focus is on the identification of levers and tools that can be adjusted to impact behaviours.

Many of the outcomes we are seeing and advising clients through are leading to deep organisational change. While progress has been made by many financial institutions, embedding risk culture throughout the institution will remain a key challenge for many years to come – cultural change does not happen overnight.

What is risk culture?

Risk culture can be defined as the financial institution’s norms and the collective attitudes and behaviours of its people that influence risks and impact outcomes. Risk culture provides a specific lens allowing general concerns about culture to focus on risk-taking and risk control activities

Accordingly every organisation has a risk culture. “Culture counts”. A sound risk culture is likely to lead to the right risk outcomes, while a weak risk culture may promote the wrong outcomes – for customers and/or the financial institution itself.” That is, in a nutshell, the message from the FSB (April 2014) and key supervisors around the world.

But what makes a risk culture “sound,” and how can firms create a sound risk culture? According to the FSB, a sound risk culture:

- bolsters effective risk management;
- promotes sound risk-taking;
- ensures that emerging risks and excessive risk-taking activities are assessed, escalated and addressed in a timely manner.

This places risk culture at the intersection of behaviour and risk management.

What should you consider to create a sound risk culture?

EY can help financial institutions to address this question. Our approach is aimed at identifying the organisation’s current cultural standards and behaviour and to determine improvement areas to reach the desired risk cultural levels and its behaviours. We use a four step approach that addresses four key questions, in the following way:

1. What is your risk culture?
2. What is this based on?
3. What are you doing about your risk culture?
4. How do you monitor your risk culture?
Addressing the four key questions

While tailored to your specific requirements, we make use of a consistent approach for the risk culture assessment. The initial assessment gives us a baseline to work from. First it needs to be defined what risk culture means for your organisation, taking into account the purpose, mission and values of the organisation. This will enable you to make the expected or desired behaviour more explicit. Breaking down risk culture into a number of components makes it possible to focus on and improve the mechanisms and behaviour, empowering you to deliver the changes you need.

Firms increasingly want to show they are improving their risk culture. Our approach helps to demonstrate the practical and pragmatic steps you are taking, which underpin the behaviours you want to encourage. Combined with an effective communication strategy about the change journey, improvements can happen and ongoing monitoring can be realised. We recognize that our clients may have differing degrees of maturity on their culture programs. We can assess their program, build their program or assist in part of their program.

Our four step approach for embedding a risk culture program can be summarized as follows:

1. Defining what risk culture means for your organisation
   - Define from a continuum of behaviours – from unacceptable to desired
   - Identify and prioritize the mechanisms which influence employee behaviour
   - Agree on an assessment approach e.g., a combination of qualitative measures including structured

2. Assessing risk culture to determine what it is based on
   - Identify areas of ‘good’ risk culture along with areas of potential vulnerability e.g., behavioral issues, mechanisms to strengthen to deliver desired behaviours
   - Prioritize gaps and identify interventions

3. Changing the risk culture through interventions
   - Agree differential investments
   - Communicate and train desired behaviours
   - Address immediate behavioral issues
   - Strengthen the mechanisms that are designed to deliver the desired behaviours e.g., HR processes, risk appetite, risk governance

4. Ongoing monitoring of risk culture
   - Agree on ongoing monitoring and/or assurance process
   - Define culture indicators for ongoing monitoring and triggers for action
   - On-going culture assessment, benchmarking and reporting
EY’s model to create and sustain a sound risk culture

While the FSB paper provides insight into the desired behaviours, it sets aside the more difficult issue of how firms can assess and change their risk culture, recognizing there are many approaches. Building on the FSB paper and our work with firms in the financial services industry, EY has developed a model that incorporates a proven methodology where cultural mechanisms and behavioural outcomes meet.

Attributes of a sound culture

Leadership - tone from the middle aligned with tone from the top and desired behaviours are established

Organisation - governance and business model support the delivery of desired behaviours and enable strong accountability and effective challenge

Risk framework - risk management framework is embedded in the way the business manages risk and enable effective challenge

Incentives - employee lifecycle and incentives support the delivery of desired behaviours
How does it work?

EY’s model incorporates the “tangible” elements of organisational structures and risk management systems (the culture mechanisms) with the more “intangible” elements of behaviour. By examining the impact of these mechanisms, risk culture – which might at first seem like an abstract concept – can be turned into something more tangible and measurable. Ultimately, this approach will create the right environment to create a risk culture which is sustainable and where strong control mechanisms reinforce the propensity of people to behave properly.

Culture mechanisms

The EY risk culture model incorporates four fundamental elements of culture mechanisms that influence and help to determine a sound risk culture: leadership, organization, risk framework and incentives. Each is tied to control mechanisms that need to be in place and work effectively.

- Leadership – communicating the right message: combines the identification of desired behaviours (behaviours standards) with the tone from the top and middle of the organization
- Organization – includes roles and responsibilities and governance. Involves establishing the right environment: combines the way that risks are managed (roles, responsibilities and accountabilities) with the quality of risk governance
- Risk framework – taking the right risks: includes risk appetite (the way it is set, embedded and monitored) and risk transparency, including the general openness of the organization to different viewpoints
- Incentives – providing the right motivations: includes the employee life cycle from recruitment through training and management, with compensation and other reward mechanisms

In assessing, changing and sustaining a sound risk culture, firms need to approach each of the eight segments of the culture mechanisms and “move the dial” by assessing the current state, the desired state and gaps; implementing and managing change; and, once the desired state is achieved, implementing sustainability programs. Managing risk culture is complex, covering tangible and intangible items across many specialisms.
Behaviours outcomes

To analyse and assess the behaviour currently in place in your organization, we developed an approach enabling measurement of behaviour in your organization. This approach can be further supported by a state of the art measurement method that is made specific for the financial services industry by focusing on the culture themes as defined by regulatory bodies. Our model identifies eight relevant segments of behaviour outcomes that relate to the culture mechanisms, as follows:

- **Lead and influence** – leading by example: inspiring others to behave appropriately, set expectations and promoting inclusiveness/diversity;
- **Analyse and interpret** – analysing and interpreting facts and information appropriately: challenging ideas and respecting different views, analysing facts and information, and making decisions, focusing on building awareness;
- **Responsible and accountable** – taking ownership of actions: committing to decisions made, taking accountability for actions, understanding of consequences and responding to issues;
- **Collaborative** – collaborating and sharing information: building interactions and rapport, resolving conflicts;
- **Ethical and compliant** – doing the ‘right thing’: espousing firm values, following procedures and rules, adherence to risk appetite, treating peers and colleagues respectfully, challenging inappropriate behaviour;
- **Communicative** – encourage communication: sharing information, raising issues/escalation
- **Adaptable** – being flexible in approach: embracing change, learning and acting on past experience and engaging in learning/self - development;
- **Advocate** – advocate for good risk management, thus serving the best interests of customers and shareholders: dealing with customers transparently and not exploiting biases, resolving stakeholder issues in a timely, effective and clear manner, applying a high quality and consistent standard in dealing with stakeholders.

In assessing, changing and sustaining a sound risk culture, firms need to approach each of the eight segments of the behavioral outcomes and “move the dial” by assessing the current state of peoples’ behavior and the desired state of peoples’ behaviour. Gaps are to be identified and changes implemented and managed in order to stimulate people to behave properly. Once the desired state is achieved, implementing sustainability programs is important for ongoing monitoring.
What do we deliver?

Our approach facilitates a structured conversation and enables a mirror be held up to the organisation. It comprises an end-to-end programme to support the establishment of a sound risk culture. Our reporting will align with the key steps in our approach:

**Define and assess risk culture**

**Strengthen and sustain risk culture**

1. Define  
2. Assess  
3. Change  
4. Monitor

To analyse and assess the mechanisms in place in your organization, we make use of interviews, group sessions and review of documentation. We review the way risk culture is implemented in the organizational design, governance and processes and controls. This includes looking at leadership, strategy, communications and supporting HR activities. Our approach also includes a questionnaire focused on the behavioural elements, to be answered by the employees of your organization. The outcomes from the questionnaire can be aggregated towards any level, to the entire organization but also towards different teams and departments (horizontal and vertical view) and can be benchmarked against the standards for a sound risk culture. The visualization of the results gives insight in the current risk culture maturity level and indicates if any behaviours are below standard and needs further attention.

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<thead>
<tr>
<th>RISK CULTURE DIMENSION</th>
<th>RATING</th>
<th>GOOD PRACTICE STATEMENT</th>
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<tbody>
<tr>
<td>TONE FROM THE TOP</td>
<td></td>
<td>Managing risk is top of mind for our senior executives. It is a genuine priority that features regularly in their various communications, both formal and informal.</td>
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<tr>
<td>BEHAVIOURAL MODEL</td>
<td></td>
<td>Through their actions, senior executives consistently take risk seriously, even if it is at the cost of short term profits, missed deadlines or disappointing influential stakeholders by refusing to compromise on operational standards.</td>
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<td>ROLES &amp; RESPONSIBILITIES</td>
<td></td>
<td>Between divisions and across our operating model there is sufficient clarity on roles, responsibilities and accountabilities to ensure we consistently manage risk effectively.</td>
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<tr>
<td>GOVERNANCE</td>
<td></td>
<td>In our governance structures, risk management, is both formally and informally, kept top of mind. For example, in marketing, product design and approval forums.</td>
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<td>RISK APPETITE</td>
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<td>Our risk appetite is clearly articulated and meaningfully cascaded throughout the firm in our governance structures and control environment.</td>
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<td>RISK TRANSPARENCY</td>
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<td>Our people and systems are appropriately configured to promptly identify risk issues. People have no hesitation in raising issues, knowing they will be dealt with appropriately without any recriminations.</td>
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<td>EMPLOYEE LIFE CYCLE</td>
<td></td>
<td>Assessing people’s aptitude for, and track record of, risk management is tangibly considered at key points in the employee life cycle. For example, recruitment, performance review, promotion and learning.</td>
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<tr>
<td>REWARDS</td>
<td></td>
<td>The way in which our people are motivated, assessed and rewarded ensures the consistent delivery of good risk outcomes for the firm, its customers and stakeholders.</td>
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How do you change and sustain your risk culture?

Based on the outcomes of the risk culture assessment, we can assist you in making a tangible, prioritised ‘road map’ which details the practical actions to take the organization to its desired state and level of maturity. In addition, our experts in people and change management can support you to address behavioural issues and strengthen the mechanisms that are designed to deliver the desired behaviours e.g., processes, risk governance, risk appetite. The risk culture assessment can be performed repeatedly, thus providing insight into the effects of interventions performed over time.

Why EY?

Our market leading expertise
- We bring together specialist knowledge in an integrated team working in a broad, international field of financial enterprises;
- We have experience in delivery of culture projects and subsequent change projects;
- We have surveyed the industry to understand challenges and actions taken;
- We have an established global risk culture working team:
  - We have developed our risk culture solutions, leveraging cross-service line skills and experience across EY;
  - We have joined up our client offerings across wider propositions such as risk appetite, conduct risk, behavioural economics, corporate ethics, etc.

Key NL contacts

If you wish to receive more information about how we can assist you, please contact our specialists within the EY Advisory Financial Services Risk practice:

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