Establishing a Culture of Risk Ownership

Responsibility, Accountability and Outcomes in a post Hayne Royal Commission World

Prepared by Sean McGing and Andrew Brown

Presented to the Actuaries Institute
Risk Insights Session
Melbourne
26 September 2018

This paper has been prepared for the Actuaries Institute 26 September 2018 Risk Insights Session.
The Institute's Council wishes it to be understood that opinions put forward herein are not necessarily those of the Institute and the Council is not responsible for those opinions.

© McGing Advisory & Actuarial Pty Ltd, Adaptive Cultures

The Institute will ensure that all reproductions of the paper acknowledge the author(s) and include the above copyright statement.

Institute of Actuaries of Australia
ABN 69 000 423 656
Level 2, 50 Carrington Street, Sydney NSW 2000, Australia
t+61 (0)2 9233 3466 **f** +61 (0)2 9233 3446
eactuaries@actuaries.asn.au **w**www.actuaries.asn.au

Synopsis

This paper aims to assist leaders of financial services and other organisations improve outcomes by improving risk culture and reducing conduct risk through better understanding:

- The hidden risks in their organisation's processes, systems and culture
- The related behaviour of its staff and partners/agents, and
- The resultant impact on consumer outcomes.

We demonstrate this by making five key observations on the state of the financial services industry. These, at their core, are little changed in the last 30 years, despite the appearance of change from multiple inquiries, stronger regulation and regulators, digital disruption and competition. With the Hayne Royal Commission as a vivid background, we explore what's driven our observations, what can we learn, and what does the financial services industry need to do to:

- Make more considered decisions in relation to effective risk management
- Bring shared focus and equitable treatment to the two very important strategic deliverables of: (1) Meeting customer needs, and (2) Meeting shareholder needs.

Our paper argues that to achieve these improved outcomes, an organisation's senior leaders need to have a deep understanding of its organisational culture. This requires an understanding of the stage of risk culture maturity of that organisation and what is required to further evolve the culture to meet customer, shareholder and emerging industry needs.

The risk function, under the leadership of the Chief Risk Officer ('CRO'), must partner with the Human Resources / People & Culture function to understand and influence the deeper drivers of culture (not just the observable aspects). And continuous action must be taken to positively shape and evolve that culture over time.

Board and management need to directly address the elements that drive good behaviour including ethics, insight, transparency, effective teamwork and communication. This is critical for employees and partnering organisations to make decisions that support best balanced outcomes for stakeholders, especially consumers and shareholders.

Keywords: Leadership, risk management, organisational culture, risk culture, conduct risk, behaviour, psychology, actuarial, financial services, Hayne Royal Commission, APRA.

Table of contents

1 Risk culture issues in financial services 3
1.1 Purpose of paper 3
1.2 Definitions – risk culture, conduct risk 3
1.3 Hayne Royal Commission 3
1.4 A similar long history 4
2 Observations of the past 30 years - challenges and opportunities 5
3 Independence doesn't exist as we have perceived it 6
3.1 Observation 6
3.2 Meeting both customer and shareholder expectations fairly 6
3.3 Eliminate conflicts of interest 7
4 Individuals ethics are both an input to and outcome of effective culture 9
5 Structures, processes and systems intended to drive good outcomes can actually do the opposite 10
6 Failure of leadership has significantly contributed to failure of organisations 12
7 Unconscious biases and exploitation of known behavioural biases in finance lead to less fair outcomes 13
8 Getting to root cause – establishing an effective risk culture 14
8.1 Culture drives financial performance 14
8.2 intentionally evolving culture 15
8.3 Risk culture attempted solutions and changes required 15
9 Appendix: The foundation research basis 18
9.1 Body of research 18
9.2 Our experience based perspective 18
10 Appendix: Risk culture - evolving levels of maturity 19
11 Appendix: Implications for actuaries 21
12 References 22

1 Risk culture issues in 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

1.1 Purpose of paper

Our paper aims to assist leaders improve outcomes by improving risk culture and reducing conduct risk by better understanding:

1. The hidden risks in their organisation's processes, systems and culture
2. The related behaviour of its staff and partners/agents, and
3. The resultant impact on consumer outcomes.

1.2 Definitions – risk culture, conduct risk

We refer the reader to one of our previous papers - *Board leadership in a complex world - optimising value from risk and opportunity* (2013)[1] where we defined risk and risk management.

We define culture using the three levels of culture in an organisation - artefacts, espoused values and tacit assumptions - as identified by Ed Schein,[2] [3] [4] global expert on organisational cultures. Tacit assumptions are the beliefs, values and assumptions about how people work together, what is true, and what is purposeful. They are often unconscious and difficult to discern, yet essential to understand as they are the foundation of culture.

We defined an organisation's risk culture as the degree to which its culture encourages or limits the taking of risks and the opportunities that arise from those risks.

ASIC[5] has defined conduct risk as "the risk of inappropriate, unethical or unlawful behaviour on the part of an organisation's management or employees".

We define ethics as the fundamental principles that define appropriate human behaviour.

1.3 Hayne Royal Commission

As we write this paper in 2018, the Hayne Royal Commission is holding a magnifying glass to the financial services industry, exposing and burning in the public

consciousness some of the more extreme actions taken by some of our biggest financial services providers which have resulted in poor outcomes for their customers.

We see these revelations as the more visible tip of the bad practice / poor organisational & risk culture iceberg. They are being documented daily in the media so we won't repeat them here. Shocking as they are, the more we look the more we see similar patterns of behaviour that have plagued many parts of our industry for decades.

1.4 A similar long history

There are too many examples of advisers' mis-selling that have directly impacted policyholders. These have ultimately impacted shareholders via costs of remediation litigation, increased regulatory obligations, and reputation damage. Examples include Storm Financial and Westpoint, and in recent years individuals in the financial planning arms of the major banks and other players.

Over the last 30 years, more subtly, policies and contract terms set within financial services companies have driven or influenced certain poor behaviours that have impacted consumers adversely. Examples include:

- High upfront commission individual risk policies sold and encouraged to surrender and re-issue
- Unrealistic illustrations of policyholder benefits (led to a need to regulate illustrations)
- Claims definition proliferation (trauma in particular, which make it harder to compare and understand if value is provided)
- Policies where claims exclusions are not transparent / obvious to policyholders
- Policies with very low loss ratios (relying on consumer ignorance / false perception of value)
- Rejecting subjective claims (for example a life company in Australia that rejected 37% of TPD claims (http://www.abc.net.au/news/2016-10-12/asic-unveils-comminsure-report-into-life-insurance/7924906))
- Unit trust products with switching arrangements with guarantees where the cost of the guarantees is born by the other policyholders
- Companies with allegedly independent advisers that sell a significant proportion of product produced by their producer-owner (see ASIC's Report 562)
- Advising clients to transfer from defined benefit funds to accumulation when it is not in their interests
- Selling product with highest commission rather than best benefits to policyholder.

To avoid this pattern continuing for the next 30 years, ***what needs to change?***

Regulations (prudential and prescriptive) have not been able to adequately change these behaviours We have to go beneath the surface, understand the full dynamics at work and then face and treat the underlying cause of poor behaviour, not the symptoms.

2 Observations of the past 30 years - challenges and opportunities

When we consider the causes of each of these impacts, we have five major observations:

- Independence doesn't exist as we have perceived it.
- Individuals ethics are both an input to and outcome of effective culture
- Structures, processes and systems intended to drive good outcomes can actually do the opposite
- Failure of leadership has significantly contributed to failure of organisations
- Unconscious biases and exploitation of known behavioural biases in finance lead to less fair outcomes

In the next five sections, each of these observations are expanded and we propose actions for addressing the observed failings.

3 Independence doesn't exist as we have perceived it

"That's one of the chief challenges, isn't it, of devising some remuneration strategy that rewards good behaviour that doesn't reflect in a dollar sign at the end of it?"

Kenneth Hayne, Royal Commissioner,
reported by Australian Financial Review, 23 April 2018

3.1 Observation

There is much evidence that the independence of financial advisers, internal advisers and even regulators has not been as strong as we would have imagined.

The elements that have impacted on independence are:

- Conflicts of interest
- Remuneration
- Long standing relationships
- Influence through ownership
- Reliance on knowledge and expertise of a conflicted party

A major consequence of these activities is a deference to the needs of the shareholder or distributor over other stakeholders such as customers. This has led to significant conduct risks and resultant bad customer and shareholder outcomes, as we have seen emerge through the Royal Commission.

3.2 Meeting both customer and shareholder expectations fairly

3.2.1 Observation

There is a critical need to be able to bring proper focus to both of the two key strategic deliverables of:

1. Customer service and delivery
2. Shareholder profit.

3.2.2 What can be done?

A parallel focus on each of these is required - both are needed for the organisation to be sustainable.

The starting point is to consider not just what the customer wants in terms of product and service, but also fairness to the customer. Start by imagining what you would feel is reasonable for your best friend or closest relative, who may not have your own deep financial services knowledge.

How would your reputation hold up if you were cross examined before a Royal Commission on your organisation's pricing and other practices and your role in introducing, justifying or accepting these practices?

With your organisation's social licence based on your fairness to consumers and related sustainable products and services, what's a good return on capital employed?

3.3 Eliminate conflicts of interest

3.3.1 Observation

The single most identified source of conduct risk is conflicted compensation / remuneration. We need to seriously rethink our current corporate model in financial services to avoid this conflict. Current media discussions declare the vertical integrated model as dead because of the depth of conflict it creates between those selling financial products and those manufacturing, despite the regulatory requirements of putting the consumer's best interests first.

Research has consistently demonstrated that "short term incentives" don't work for more complex tasks because:

- They incentivise individual interests over the best interest of the whole (allocate resources to me and my team to get our bonus)
- They encourage non creative / overly safe behaviour (only do what you get incentivised for) so opportunities are not always taken or are diluted
- They create competition and potential resentment between people
- They encourage short-termism

There is a need to reflect on long term incentives also, as they have different consequences; for example, more likely to improve retention of staff but they may not be the best people for the business.

3.3.2 What can be done?

As Dan Pink[6] has said "When the profit motive becomes unmoored from the purpose motive, bad things happen". Consider how to align incentives and policies so that people can better engage with their sense of purpose, mastery, autonomy and relatedness.

Consider how to strengthen enforcement mechanisms to reduce any conflicts.

Examples include:

- Intentionally eliminate conflicts of interest; where there are representatives on industry bodies with conflicts, the body needs to be chaired / overseen by person from independent body who has final say

- Strengthen conflicted remuneration regulations (revisit FOFA) in light of Royal Commission insights and recent market developments

- Strengthen regulatory enforcement against organisations that don't enforce appropriate measures against misconduct (for example, not enforcing clawback provisions)

- Strengthen the powers of independent bodies to assess complaints against advisers/ organisations - (for example give the Australian Financial Complaints Authority (AFCA) stronger enforcement powers)

- Consider restricting ownership and / or regulate to break up of entities to force independence and lack of conflicts (ban vertical integration)

4 Individuals ethics are both an input to and outcome of effective culture

"In any business you are faced with ethical dilemmas every day.
If you don't bring ethics into a decision-making process you will destroy value"

Pauline Vamos, former Regnan CEO,
reported by Australian Financial Review, 24 April 2018

4.1.1 Observation

While a large proportion of people are likely to behave ethically for a large proportion of the time, things get much murkier when people are facing either extreme gains or losses of any size. Daniel Kahneman's research has concluded that we are loss averse rather than risk averse. Our observation is that people may take significant risks with other people's money (shareholders or customers) to avoid personal loss.

To enable people to make consistently ethical decisions requires a culture that supports and encourages ethical decision making, and has a zero tolerance for unethical behaviour. This requires strong ethical role models and mentors. It also requires much deeper personal insight and awareness and a deep sense of personal responsibility. And it requires strict enforcement of consequences when ethical breaches occur.

So, what do you want an individual to do?

1. Take responsibility for all that emerges from current behaviour, and hence take action.
2. Ethical weigh up of different strategies.
3. Be transparent, thus facilitating the right actions.
4. Observe and call out wrong behaviour.
5. Seek help

4.1.2 What can be done?

Behaviour change is a significant undertaking. While behaviours may be changed in the short term through incentives and or punishment, longer term change is less likely wilthout understanding and evolving the underlying beliefs and mindsets. For example, a shift in belief from "it's only wrong once you get caught" to "it's not okay to act inappropriately" is a significant shift that will lead to much broader change than large penalties for getting caught.

Developing a strong ethical mindset rarely occurs in a single event or program, but requires ongoing diligence to practice and reflect on personal behaviours and their consequences to others, in real life scenarios.

It also requires an understanding of our default behaviours and what underlying beliefs drive these. Robert Kegan, Harvard Professor in Adult Learning and Professional Development, has researched what stops adults from changing for over 30 years. They have developed methods to overturn our deeper beliefs that can cause us to revert to default behaviours (our "psychological immunity system").

5 Structures, processes and systems intended to drive good outcomes can actually do the opposite

5.1.1 Observation

Our organisations, especially our larger organisations are centres of complexity. Complexity created over time. Ultimately this was created by human beings who through the lens they were viewing, established processes, structures, policies and practices intended to create effective operations.

However, the unintended consequences of many of these systems has been severe. The following are some key examples:

Organisational structure

Large organisations typically have multiple levels of formal and informal hierarchies. Matrix management adds extra dimensions. Yet, these traditional corporate structures have inherent flaws – their hierarchies stifle autonomy, limit openness, and prevent the democracy of debate.

These can all have disastrous consequences from a risk perspective.

Risk and compliance practices

Compliance regimes focus attention on risks on the compliance list rather than taking holistic approach or encouraging responsibility for wider risk management. As the APRA Prudential Review into CBA observed, these have often created compliance to a process rather than compliance to an outcome.

The three lines of defence model increases oversight. For the first line, this may increase complacency or reduce responsibility (someone else is looking at the risk and that's their job). For example, we sometimes hear from risk officers how the first line may respond to lack of traction on a risk issue as a lower priority for them than the risk team.

Incentive systems

Incentive systems have often created conflicting goals and led to poor consumer outcomes. Unless incentives create an alignment between customers, providers and advisors, bad things will happen.

Conflicted remuneration incentivises the wrong behaviour. As human beings facing into these conflicts we haven't proved to be ethically mature enough to adequately address this paradox.

5.1.2 What can be done?

Each of these challenges requires a deeper understanding of the systems we are part of. We must ensure any structural solutions we put in place (risk policies,

organisational structures, incentive schemes) are fully aligned to desired outcomes, and potential consequences are carefully considered.

Structures and systems can influence and shape people's sense of what is possible (their self efficacy) and their ways of working (can make collaboration easier or harder). Systems, structures and policies must carefully consider how these impact on people's experiences and beliefs.

For effective risk outcomes, this will include systems and structures that

- build confidence that people can safely speak up
- encourage and reward effective outcomes
- reinforce the importance of risk ownership and personal accountability.

6 Failure of leadership has significantly contributed to failure of organisations

6.1.1 Observation

Leaders have the responsibility to put in place the appropriate culture and structures, processes and systems that support that culture and the company's strategy.

Brown and Balasingham's paper, *Leadership and Life Insurance Failures*[7], identified the key themes that led to failure of insurance organisations. These themes were primarily related to senior leadership.

While the actions of senior Leaders have led directly to significant failure, they have also indirectly led to poor risk cultures. Ed Schein has identified that two of the top four influences on culture are what leaders pay attention to and what leaders role model.

6.1.2 What can be done?

Leaders at Executive and Board level must set the tone from the top, and leaders through all layers of management must set the tune in the middle.

The executive function is ultimately responsible for organisational culture. While the risk and people functions have responsibilities to embed practices and processes that influence and shape culture, this is on behalf of the whole executive team. Ways that the senior executive can demonstrate ownership include:

- Bring in incentive schemes and structures that symbolically recognise customer and shareholder as "equal" stakeholders; take out any structures or incentive schemes that could lead to conduct risk
- Enforcement of consequences for unethical behaviour
- Build in to each conversation – is this in the best interests of the customer?

7 Unconscious biases and exploitation of known behavioural biases in finance lead to less fair outcomes

"We are not the paragons of reason we assume ourselves to be."[8]

The Economist on Daniel Kahneman's book *Thinking Fast and Slow*, 2011

7.1.1 Observation

Daniel Kahneman's research on unconscious biases highlights the importance of understanding unconscious biases. This is critical both in decision making inside organisations and also in ensuring that products or processes are not designed to take advantage of customer unconscious biases.

Some examples of potentially taking advantage of customer unconscious biases include:

- Limited comparisons of products to stifle competition
- Over simplifying choices
- Underestimating size of long term effects e.g. trail commission
- Loss aversion
- Focus on stories that manipulate emotions and evoke anxiety

7.1.2 What can be done?

Organisations can put in place management practices that reduce the effect of unconscious biases. For example, choice overload can be reduced by well designed default investment settings in a superannuation fund.

Regulators can put in place regulations that reduce the effect of unconscious biases. For example, regulate for full transparency of costs and their effects, such as disclosure requirements to show present value of future customer fees.

Organisations can also communicate and reinforce the following ways to reduce the impact of biases:

- Be transparent about what you are thinking and how you make decisions
- Highlight positive role models to counter-balance negative stereotypes
- Set clear intentions before making decisions - tell yourself what you intend to achieve. For example, setting clear criteria for role selection
- Apply many small acts of encouragement (opening doors to opportunity, gestures of inclusion and caring, and acts of respectful listening)
- Slow down and pay attention – when do you automatically judge?
- Be curious - seek out different views and perspectives, seeing everything different as an opportunity to learn, observe!!
- Value and acknowledge difference – create and encourage an environment that recognises importance of diverse views and challenging the status quo
- Lead with Empathy - imagine what another person might be thinking or feeling

8 Getting to root cause – establishing an effective risk culture

"Top companies with bad culture have underperformed the ASX200 by close to 20% over the past 5 years"

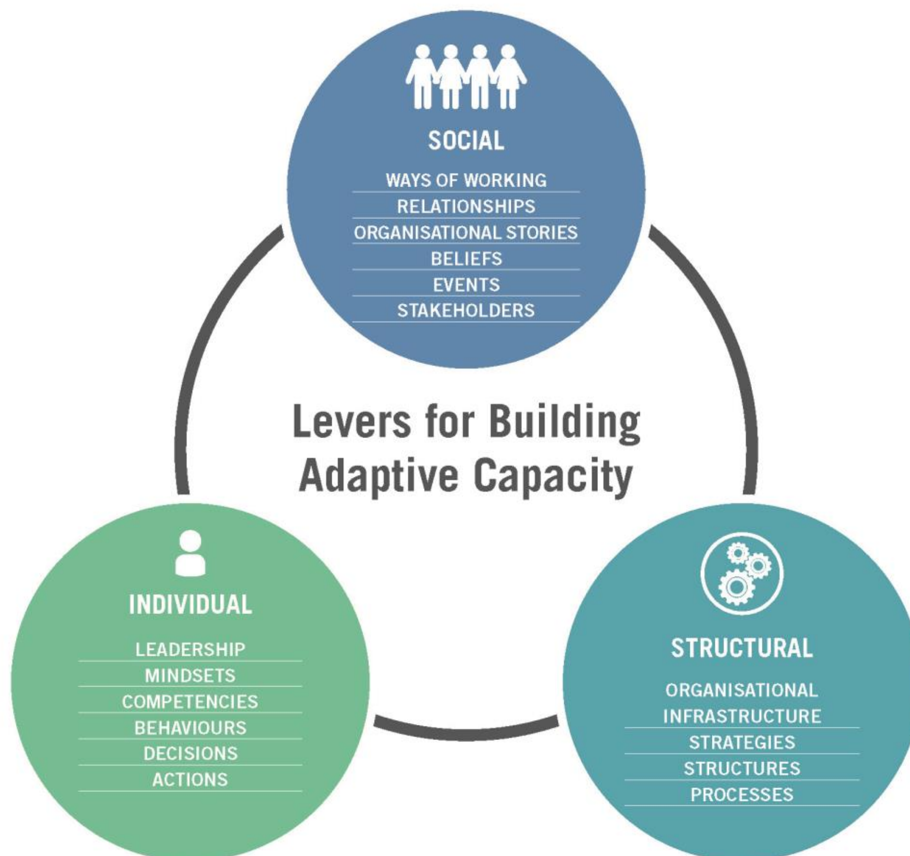
Regnan, reported by Australian Financial Review, 24 April 2018

8.1 Culture drives financial performance

There is significant evidence that culture is a key contributor to financial performance and outcomes. This becomes increasingly obvious as we see the consequences of inadequacies in corporate cultures. Culture is complex, as it requires an understanding of the deeper beliefs and motivations that drive human behaviours, as well as the impact of the current environment and behaviours of other people

This means culture must work simultaneously at all 3 levels – Individual, Social and Structural.

The graphic below is a description of the key levers of culture (copyright Adaptive Cultures),



- Culture must be founded on sound ethics.
- It must be open and transparent.
- It must enable trusting working relationships across the most limited hierarchy that is practical.

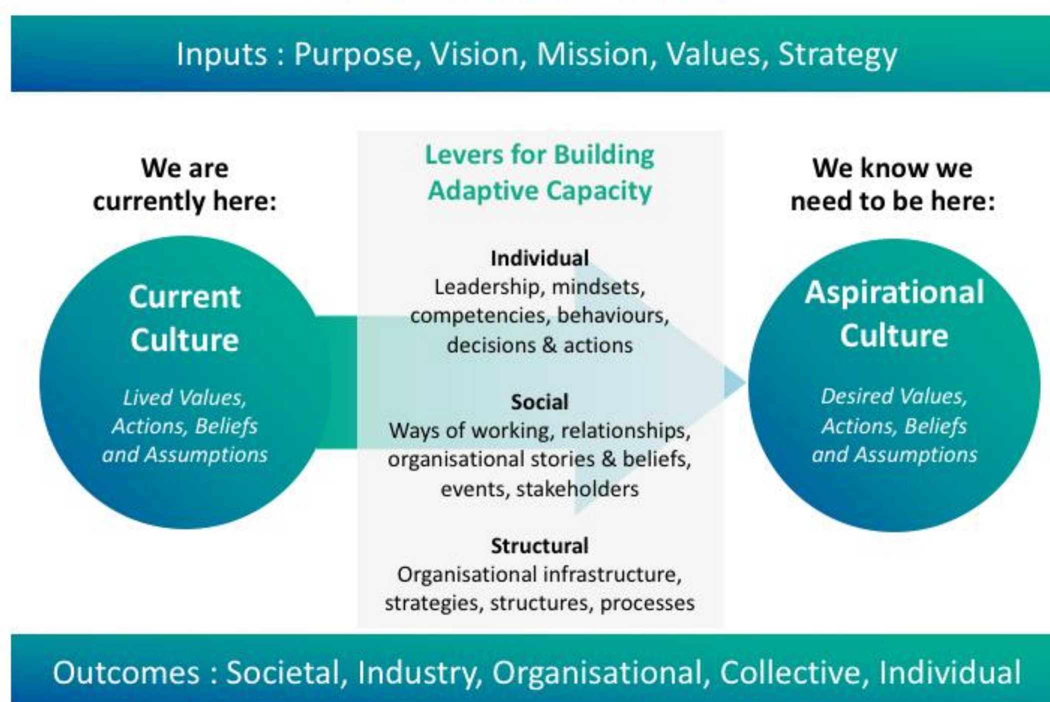
The journey must aim to continually evolve the organisation's culture towards a progressively healthier, more sustainable and effective enterprise. And this will take time.

8.2 intentionally evolving culture

The maturing of an organisation's risk culture is as real and as important as the process of evolution. Organisational culture needs to continuously improve and evolve in order to survive and thrive.

8.3 Risk culture attempted solutions and changes required

To actively evolve risk culture, risk and opportunity must be actively considered in an informed way. This means understanding risk culture as a constantly evolving phenomenon that is shaped by the individual, social and structural aspects of an organisation. In particular, individual mindsets, attitudes and beliefs are central.



The Table on the next page examines a range of traditional "solutions" that are likely to have only limited success. We consider when they work, when they don't and going forward what changes are required to mitigate the risks and improve outcomes.

Table 8.1 Effective Risk Culture initiatives

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
Regulations	Sets limits Intent of regulations followed Regularly enforced	Staying within the letter of the regulations but outside the intent Regulations ignored or not adequately enforced	Shift mindset from "it's not okay to get caught" to "it's not okay to not honour the intent of the regulations."
Independent reviews	When truly independent Fresh pair of eyes can identify blind spots	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

Establishing a culture of risk ownership

Risk Culture initiatives	*When this is effective*	*When this is ineffective or detrimental*	*Mitigation / Improvement Required*
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 to 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 it must be managed effectively

9 Appendix: The foundation research basis

9.1 Body of research

Our observations, ideas and suggestions are founded on a large body of research by some of the best recognised experts in the culture and behaviour space. These include:

- Organisational culture — Ed Schein
- Psychology of adult development — Robert Kegan
- Human meta model — Ken Wilber
- Morality — Lawrence Kohlberg
- Organisational complexity — Ralph Stacey
- Motivation — Dan Pink

Since the financial service failures of the GFC globally, much applied research has been done in the financial services regulatory area. This includes:

- Financial Stability Board (FSB)
- Financial Conduct Authority (UK)
- APRA

9.2 Our experience based perspective

Our perspective comes from:

- Our experience in:
  - working within organisations as corporate employees,
  - working as consultants and advisors on risk management, operational and financial matters,
  - advising on, and implementing change, in organisational culture and leadership to organisations in financial services and other industries
  - serving as non-executive directors on not for profit boards.

- Our applied research as published through Actuaries Institute papers and directly through our companies, along with our presentations to conferences and companies.

- Our core actuarial skill set.

This combination has led to a wide and deep pragmatic and commercial perspective on organisational and risk culture.

10 Appendix: Risk culture - evolving levels of maturity

What does our analysis tell us about the state of organisational / risk culture maturity of an organisation? Table 10.1 below, taken from our 2013 paper[9], sets out how the different elements of risk culture evolve from simply operating subconsciously to the ideal of a mature risk culture.

Table 10.1 Risk Culture Maturity Rubric

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
Organisat-ional 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 organise / take responsibility	Partnership between management and workforce; shared responsibility
Individual behaviours	Takes many risks without realising it, blissful ignorance	Meets minimal legal or compliance requirements; 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 communic-ation 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

Source: A. Brown and material provided by S. Bennett (Enhance Solutions). Adapted from a method by Patrick Hudson[10] applied to safety cultures.

Examining Table 10.1 in this light, we can see that where culture initiatives are ineffective, the prevailing risk culture maturity level is unaware, reactive or at best mechanical. To enable effective risk culture initiatives as illustrated, the organisation must become pro-active.

The Table 10.1 findings can be fitted to the three key components of our culture maturity model:

1. Individual – Taking responsibility, being accountable – or not.
2. Social - Social structures within the organisation – who talks to who; politics; what becomes acceptable or not.
3. Structural - Governance, reporting and risk frameworks; hierarchy, bureaucracy, complexity vs clarity.

An example of social risk is when tolerance of poor behaviour beyond one's immediate area, justified because the poor behaviour leads to a "successful outcome", with direct flow on effects (e.g. higher bonus).

Good social structures mean better cross organisation discussion and can help identify emerging risks within.

11 Appendix: Implications for actuaries

"It is devastatingly simple: an abuse of customers' trust by charging them for no service or lousy financial advice. Guilty."

Jennifer Hewitt, Australian Financial Review, 23 April 2018

Actuaries fill roles in the financial services industry from Board members, through senior management and leadership roles, to Appointed Actuary, Chief Risk Officer, product and pricing actuaries, data analytics experts and others.

Actuaries bring a strong commercial and prudential perspective to these organisations and roles, and have a deep understanding of financial and organisational systems. Yet actuaries have been at the table when many decisions have been made that have been detrimental to the customer and ultimately to the shareholder.

While the actuarial role is often as advisor rather than decision maker, we wonder of things may have been different if individual actuaries had taken a stronger stance on issues such as pricing for extremely low loss ratios. Many products designed by actuaries have compensation designs that clearly create conflicts.

<u>What can actuaries do?</u>

- Uphold customer outcomes as a core decision maker in pricing
- Ensure internally that products are being underwritten, administered, and claims assessed in line with original intention
- Ensure that product design encourages alignment rather than anti-selection
- Challenge any processes or practices that reduce transparency or increase the chances of unfair outcomes to customers

12 References

[1] McGing, S and Brown, A., 2013, Actuaries Institute, *Board leadership in a complex world - optimising value from risk and opportunity*
https://www.actuaries.asn.au/Library/Events/SUM/2013/Sum2013PaperAndrew%20Brown%20Sean%20McGing.pdf

[2] Schein, E., August 2009, *The Corporate Culture Survival*, Guide.

[3] Schein, E., August 2010, *Organizational Culture and Leadership*, Jossey-Bass

[4] Schein, E., *Edgar Schein's Ten Change Steps,* website
http://www.theleadershiphub.com/files/EdgarScheinsTenChangeTips.pdf

[5] APRA (quoting ASIC), October 2016, *Information Paper - Risk Culture*

[6] Daniel Pink , 2009, *Drive: The Surprising Truth About What Motivates Us*

[7] Brown, A. and Balasingham, B., 2013, Actuaries Institute, Leadership and Life Insurance Failures – What can we learn about Financial Leadership?
https://www.actuaries.asn.au/Library/Events/SUM/2013/Sum2013PaperAndrew%20Brown%20Bimal%20Balasingham.pdf

[8] Daniel Kahneman, 2011, *Thinking Fast and Slow (Penguin)*

[9] See reference 1.

[10] Hudson, P., 2013, *Safety Culture – Theory and Practice*,
http://ftp.rta.nato.int/public//PubFulltext/RTO/MP/RTO-MP-032///MP-032-08.pdf