Risk Culture:
The Heart and Soul of Enterprise Risk Management

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KPMG
cutting through complexity

- **Introductions**
- **What is Culture – The Culture "Iceberg"**
- **Evidence from the field – Recent Survey Data**
- **Why is Culture Important?**
- **What is Risk Culture?**
- **Risk Culture – An Integral Part of ERM**
- **Benefits of a Strong Risk Culture**
- **What does a "good" assessment of Culture look like?**
- **Approaches to assessing Risk Culture**
- **Questions**

Formal (Overt) Aspects

The way we __say__ we get things done.

Directly Observable Characteristics

Policies and Procedures
Resources
Goals
Technology

Beliefs
Perceptions
Assumptions
Attitudes

About formal and informal systems.

Less Observable Characteristics

Norms of [Group] Behavior
Informal Interactions
Values
Feelings

Informal (Covert) Aspects

The way we __really__ get things done.

An organisation's culture exists whether its leadership __intentionally__ seeks to cultivate one or not.

Source: Stanley N. Herman, TRW Systems Group, 1970

Evidence From the Field*

A recent 2016 study of more than 1,300 North American firms revealed the following findings regarding the importance of corporate culture:

- ❑ **91%** of executives believe culture is *"important" or "very important"* at their firm.

- ❑ **79%** rank culture as *at least a "top 5" factor* among all things that *make their firm valuable*.

- ❑ **92%** of executives studied **believe improving culture would increase firm value**.

- ❑ **85%** believe a *poorly implemented, ineffective culture* increases the chance that an *employee might act unethically or even illegally*.

- ❑ *Only 16% believe* their firm's culture is *where it should be*.

- ❑ Key cultural **values** include *integrity, collaboration and adaptability*.

Source: Corporate Culture: Evidence From the Field, John R. Graham Duke University & NBER, Campbell R. Harvey Duke University & NBER, Jillian Popadak Duke University, Shivaram Rajgopal Columbia University, September 13, 2016.

Here we go again! Headlines are increasingly focusing on the human side of control failures...

- Wells Fargo to Pay $187.5M for Wrongfully Opening Customer Accounts
- Wells Fargo's Cross-Selling Prowess Backfired!
- Wells Fargo Customers Join Cross-Selling Backlash

The [effectiveness of] corporate culture is determined not just by stated cultural values but also by whether employees _act_ according to _social norms_ that are _consistent with those values_, and whether _formal structures_ such as governance _reinforce the values_.

Norms of Behavior and Attitudes Relative to:

Risk <u>Awareness</u>

Risk <u>Taking</u>

Risk <u>Management</u>

Directly Observable Characteristics

Less Observable Characteristics

"<u>The norms of behaviour </u>for individuals and groups within an organisation that <u>determine the collective ability to identify and understand, openly discuss and act on </u>the organisations current and future risk"

2009 International Institute of Finance,
Reform in the financial services industry:
Strengthening Practices for a More Stable System

Why Focus on Risk Culture?

65%

Organizations increasing their focus on risk culture and awareness in response to current and emerging business risks

Source: 2014 AFP Risk Survey

- Most FIs strong at measuring risk in the traditional sense.

- Somewhat **lacking at measuring and monitoring behaviour** within their organisation.

- Org need [a **robust, repeatable, reliable**] means to help ensure that people are exhibiting good **risk-related behaviours**.

Risk Culture - An integral part of ERM

Risk culture is one of the key elements in an organization's Enterprise Risk Management Framework.

Risk culture both influences and is influenced by the other ERM framework elements.

Risk culture influences an organization's risk appetite, and governance in a reciprocal manner.

Recent research demonstrates that It is possible for an organization to evaluate their risk culture specifically and to measure the system of values and behaviors present throughout an organization that shape risk decisions.

Benefits of a strong and positive risk culture

A strong and positive risk culture has the potential to:

► **Reduce** the risk of misconduct

► **Diminish** the risk of regulatory scrutiny and the risk of related supervisory action and monetary fines, as well as diminish other potential costs, such as operating or capital charges

► **Enhance** a firm's reputation with key stakeholders:

- Customers/clients

- Employees and management

- Shareholders

- Regulators

► **Strengthen** asset and earning quality (increased reliability/reduced variability of outcomes)

► **Promote** innovation and new product development designed to serve customers

► **Attract and retain** highly qualified talent that similarly values a strong positive culture, good behavior, and reduce counterproductive behavior and employee turnover

► **Protect** the brand

What does a good assessment of Culture look like?

	Cultural drivers		Entity level instruments
Knowledge & Understanding	**Clarity** *Are rules, (risk) policies and procedures accurate, concrete and complete and do employees understand what is expected?*	**Visibility** *Is employee behavior, e.g. the risk responses and the effects thereof visible within the organization?*	Strategic objectives and key risks Cascading statement and metrics Related role descriptions and expectations Policies and processes Management information
Belief & Commitment	**Involvement** *Do employees feel accountable for the proper use of risk policies and take ownership for the strategy of the organization?*	**Role Modeling** *Does management lead by example and display leadership, especially regarding risk management?*	Information moments Governance Management messages Part of (management) agenda
Competencies & Context	**Practicability** *Do the organization's targets correspond to the risk appetite and overall risk strategy and are employees enabled to do what is requested of them in terms of managing risks?*	**Openness** *It is normal to discuss (latent) risks and is there an atmosphere of both challenge and mutual respect?*	Access to expertise Competency profiles Processes stimulating consideration Tools: workshops, assessments
Action & Determination	**Enforcement** *Are employees rewarded for responsible behavior and is irresponsible behavior disciplined?*	**Improvement** *Are incidents and 'near misses' evaluated to determine potential risks and do employees feel they learn from their mistakes?*	Escalation procedures Key Performance Indicators (KPIs) Root cause analyses and recommendations Aggregation of risk information Tracking recommendations

What does a good assessment of Culture look like?

Achieving a holistic understanding of an organisation's risk culture, can be done through the following methods…

Appropriate	Adequate	Effective

Method

Appropriate / Adequate:

#1 Mechanism review

- P & P evaluated against industry standards, best practices and regulatory expectations.
- Allows the firm to understand if policies and processes, Exist; Have clear ownership; Are Embedded into ongoing management processes and governance structures.

Effective:

#2 Incident review (AAR)

- Review risk incidents, near misses and breaches. ("Hot Wash"; MLR).

#3 Survey, interviews and focus groups

- Baseline and ongoing assessment of values, attitudes, observed behaviours.

Results

Does a framework exist?	Would it work if it were used?

Key Insights, Facts and Data Relative to:
- How people actually manage risk
- How do perceptions of risk culture differ across hierarchies and micro-cultures?
- Potential gaps between defined policy and

The use of multiple lenses provides a complete picture of where cultural issues originate – in the articulation of policy or the way in which people ultimately behave.

Questions

Risk Culture Engagement

Example Deliverables

Entity Level Instruments

Report on Analysis of Entity Level Instruments

. Via documentation reviews, surveys, interviews and/or workshop we collect information about entity level instruments.

We analyze this data on three aspects:

1. *Presence* means that the entity level instrument is present
2. *Quality* is the entity level instrument of sufficient quality in KPMG's view (Complete, current, clear ownership, accessible, consistent, governance, etc.) to support management and employees with the desired risk culture
3. *Implementation* means the entity level instrument is implemented in a way that all management members and employees could be aware of the entity level instrument

Entity level instruments	Presence	Quality	Implementation
Knowledge and Understanding			
Strategic objectives and key risks	Yes	Yes	Yes
Risk policies and processes	Yes	Partially	No
Belief and Commitment			
Consistent management messages	Partially	No	No
Part of (management) agenda	Partially	Partially	No
Competences and Context			
Competency profiles	Yes	Yes	No
Assessments	Yes	Yes	Partially
Action and Determination			
KPIs	Partially	No	No
Tracking recommendations	No	No	No

Yes	Partially	No

Risk Culture Perception Survey

Risk Culture Perception Survey – Representative Example

A survey can measure the implementation and understanding of *risk management*. The survey also provides an understanding of attitudes and perceptions regarding risk culture.

The survey can include demographic questions understand seniority, function, location, and business unit of the respondent.

The table on the right gives an impression of possible questions.

Risk Culture Survey

	Fully disagree	Disagree	Partly disagree/ partly agree	Agree	Fully agree	Not applicable
Clarity						
Risk information is effectively communicated up and down from my department.	O	O	O	O	O	O
The level of understanding of the department's policy for managing risk is high within my department.	O	O	O	O	O	O
Visibility						
I see sufficient evidence of business decisions taking risk into account.	O	O	O	O	O	O
I believe my local managers and supervisors know how employees manage risks.	O	O	O	O	O	O
My department is fast enough to realize when things begin to go wrong.	O	O	O	O	O	O
I believe my local managers and supervisors know what type of behavior really goes on within the organization.	O	O	O	O	O	O
Within my department or work unit the opportunity to engage in misconduct is minimal.	O	O	O	O	O	O
Within my department or work unit adequate checks are carried out to detect risks.	O	O	O	O	O	O

Representative example of a survey.

Understanding Cultural Drivers From Survey Results – Representative Example

All outcomes of the survey are collected per cultural driver and translated into negative, neutral, and positive.
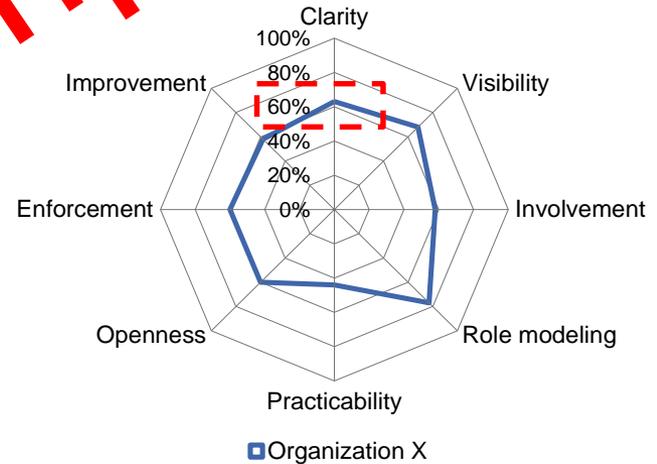
Negative = Fully disagree + Disagree

Neutral = Partly disagree/partly agree

Positive = Fully agree + Agree

The average positive outcome of all questions, represent each cultural driver. All outcomes are represented in a report via a table with all questions, a table with an overview of all cultural drivers and a spider web of all cultural drivers.
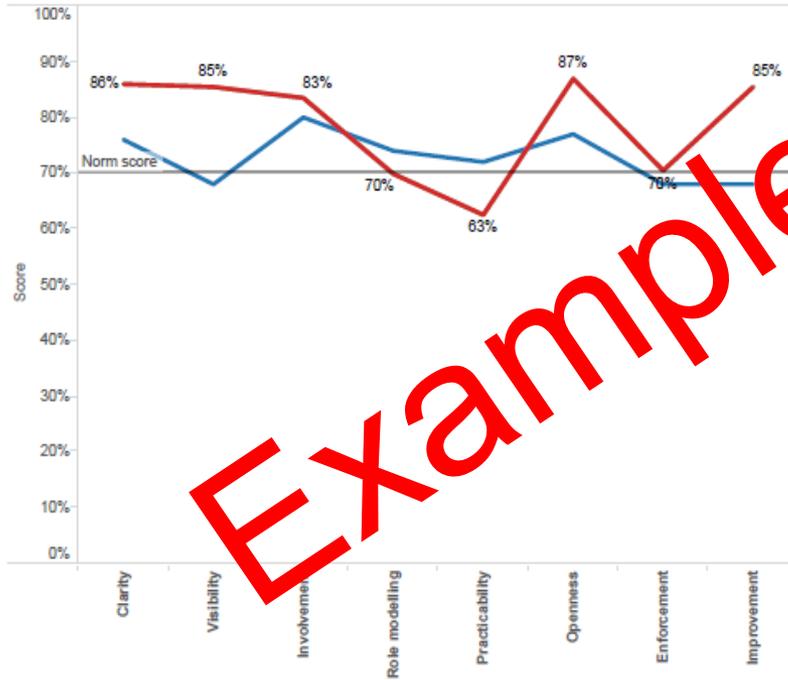
Organization X

Clarity (63%)	Organization X		
	Negative	**Neutral**	**Positive**
I am confident that I could describe the benefits of having a risk management policy	8%	12%	80%
The level of understanding of the department's policy for managing risk is high within my department	40%	5%	45%
The management's appetite for allowing to take some risks is clear to me	30%	6%	64%

Cultural drivers	Results Organization X
Clarity	63%
Visibility	68%
Involvement	58%
Role modeling	77%
Practibility	44%
Openness	60%
Enforcement	60%
Improvement	58%

Cultural driver *	Client Results	KPMG FS Benchmark
Clarity	86%	76%
Visibility	85%	68%
Involvement	83%	80%
Role modelling	70%	74%
Practicability	63%	72%
Openness	87%	77%
Enforcement	70%	68%
Improvement	85%	68%

Role modelling, Practicability and Enforcement are at or below the baseline of 70%. This means that these drivers have a higher risk of negatively impacting the risk culture at Euroclear. This baseline is based on global scientific studies and global experience of KPMG over 20 years, related to all different sectors. The KPMG FS Benchmark is based on results of financial institutions over the last 5 years.

* The score on every cultural driver is based on 'fully agree' and 'agree' answers, with an adjustment for 'do not know'. This means that the 'do not know' answers are excluded.

Questionnaire
Pre-announcement   13th of October 2015
Invitation Reminder   15th of October 2015
Second reminder   22nd of October 2015
Closing   28th of October 2015
                                      2nd of November 2015

Response
Invitees   3640
Response (number)   2203
Response (%)   **61%**

Analysis of Cultural Drivers and Risk Rates

Based on the outcomes of the cultural drivers we could give risk ratings for each driver.

These risk rates represent the possible impact of the effectiveness of risk culture.

**The colors represent the risk rate. Rates are based on KPMG benchmark data.**
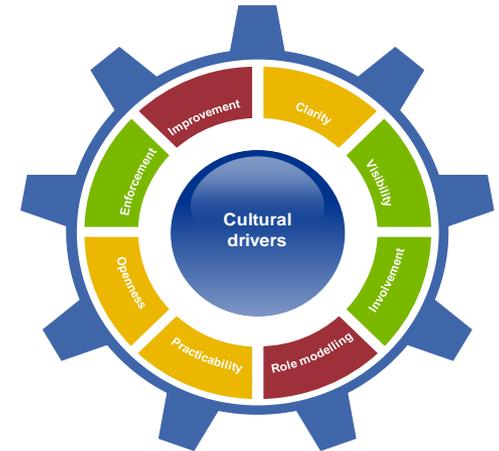
Risk rate Cultural drivers	Low risk*	Medium risk*	High risk*
Clarity	Minimum of 90%	Between 80 - 90%	Lower than 80%
Visibility	Minimum of 80%	Between 65 - 80%	Lower than 65%
Involvement	Minimum of 80%	Between 65 - 80%	Lower than 65%
Role modeling	Minimum of 90%	Between 80 - 90%	Lower than 80%
Practibility	Minimum of 80%	Between 65 - 80%	Lower than 65%
Openness	Minimum of 80%	Between 65 - 80%	Lower than 65%
Enforcement	Minimum of 90%	Between 65 - 80%	Lower than 65%
Improvement	Minimum of 80%	Between 65 - 80%	Lower than 65%

Low risk: There are no additional measures necessary to strengthen the effectiveness of the cultural drivers.

Medium risk: Cultural drivers are not effectively embedded in the organization or sufficiently prevent undesirable behavior and stimulate the desired risk culture.

High risk: Cultural drivers are not effectively embedded in the organization to prevent undesirable behavior and stimulate the desired risk culture.

* Metrics are expressed as a percentage of respondents who answered positive to the questions in the survey.

KPMG Risk Culture Maturity Model – Benchmark

Need to be developed with benchmark data

	Basic		Mature		Advanced
	Minimal Process In Place		A Management Process		A Strategic Tool

	Weak	Sustainable	Mature	Integrated	Advanced
Knowledge & Understanding		◆ (current)		◆ (benchmark)	
Belief & Commitment		◆ (current)	◆ (benchmark)		
Competencies & Context	◆ (current)		◆ (benchmark)		
Action & Determination		◆ (current)	◆ (benchmark)		

Basic
- Basic staff awareness of risk management
- Leadership has set the tone but employees do not consider risk to be their responsibility
- Informally considered in delivering work
- Informal communication process
- Risk identification is isolated and ad hoc
- Adherence with the risk process is low

Mature
- Risk communication programs are formal
- Staff are aware of their risk responsibilities and risk is discussed openly
- Leadership has set the tone and most employees see the benefit of applying risk management
- Risk is considered for major items in key decision making forums
- Risk identification is done in a structured, timely manner at top levels
- Adherence with the risk process is high at the strategic level

Advanced
- Right people are actively involved in the risk management process
- Employees understand the organization's risk strategy and profile
- All employees value risk management
- Risk formally considered in key decision making forums
- Systems and rewards are aligned to reinforce risk management processes
- All employees participate in identification and treatment of risk in a timely and coordinated manner
- Risk management process applied at strategic and operational levels

◆ = current state

◆ = benchmark

Example

Risk and Compliance After Action Review

Final Report Content Outline (Example)

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Example