Importance of culture

Risk, redefined

MEARIE conference

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Written by

Katherine Macpherson
Canadian Non-Financial Risk Leader, EY

Building a better working world

Lessons learned since the global financial crisis

Headlines from the last 5 years

CBC's "Go Public" investigation in 2016

- Hundreds of frontline employees from Canada's largest banks told CBC News in November 2016 that managers coerced them to mislead clients into buying unnecessary or unnecessarily high-cost products, including credit and insurance, which placed customers at a financial disadvantage.
- The banks denied any wrongdoing and stressed their commitment to customer satisfaction.
- This investigation triggered several regulatory reviews, including FCAC and OSFI's industry reviews

Wells Fargo fined $1B for mortgage and auto-loan abuses

- WF admitted to selling auto insurance to hundreds of thousands of auto-loan customers that did not want or need it. Hundreds of thousands of customers that could not afford the combined auto loan and extra insurance payment fell behind on payments and had their cars repossessed.
- WF admitted to charging thousands of customers unnecessary fees in order to lock in their interest rates on home mortgages.

Royal Commission into Misconduct (Australia)

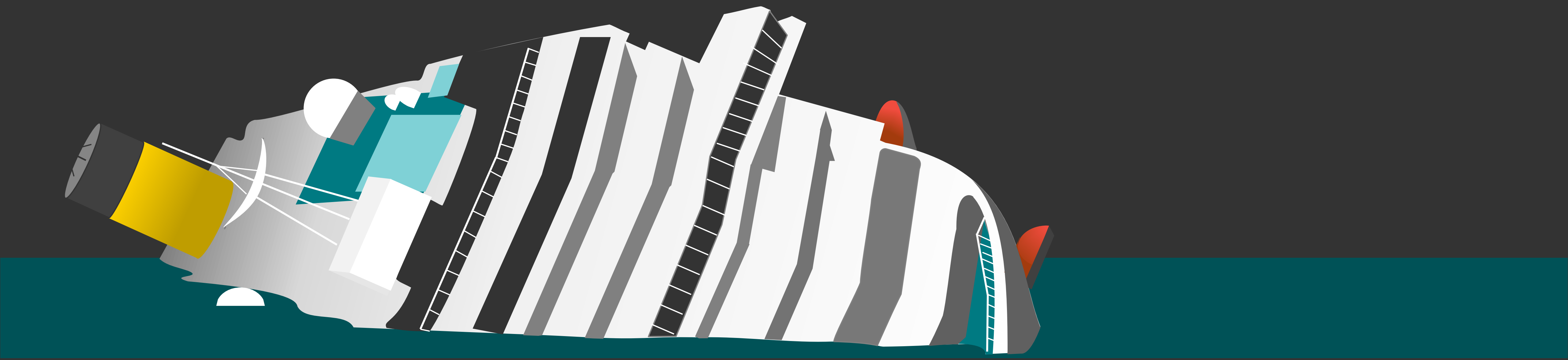
- AMP and Commonwealth Bank admitted to charging customers for services they did not provide. Other institutions have admitted to charging fees to dead people (many who have been dead for many years)
- AMP also admitted it made false or misleading statements to the regulator, the Australian Securities and Investment Commission
- ANZ admitted to improper conduct in financial planning and wealth management arm, including forged signatures, impersonation of customers, fraudulent use of PoA, false witnessing of documents, and the transfer of customers' funds to advisors' personal accounts.

FCAC report on Canadian banks' retail sales practices

- Retail banking culture is predominantly focused on selling products and services, increasing the risk that consumers' interests are not always given the appropriate priority.
- Banks' financial and non-financial incentives, sales targets and scorecards may increase the risk of mis-selling and breaches of market conduct obligations.
- Certain products, business practices and distribution channels present a higher sales practices risk.
- Governance frameworks do not manage sales practices risk effectively.
- Controls to mitigate the risks associated with sales practices are underdeveloped.

Costa Concordia

Case Study



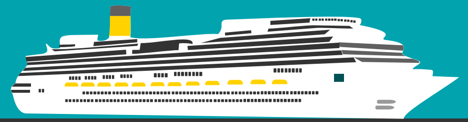
Costa Concordia
What happened?

On January 13, 2012, the Costa Concordia cruise ship struck land at 9:45 PM while on route to Savona, Italy, with 3,206 passengers and 1,023 crew members on board.

Impact of the crash

- **Unnecessary loss of life**
  32 passengers confirmed dead, 1 salvage operator
- **$2 billion dollar cost**
  Includes victims' compensation, refloating, towing and scrapping costs
  (more than three times the $612 million construction cost of the ship)
- **$1 billion dollar loss in market capitalization**
  The value of Carnival Corporation’s shares fell 17% following the disaster, down as low as 30% before recovering
- **6 individuals found criminally responsible**
  Captain Schettino was sentenced to 16 years in prison, and five other officers were found guilty of manslaughter, negligence and wrecking.
- **Subsequent oil spill led to further legal action**
  The Ministry of Environment took legal action against the cruise liner following environmental damage caused by oil leeching from the damaged hull.

Events leading to the crash



Prior to departure
Crew members from 60 different countries, speaking different languages, some have not performed their mandatory bi-annual emergency training drill

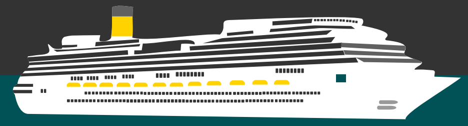
19:00
Passengers board ship and receive instructional video training for emergency events

21:15
Ship takes a five mile detour to pass closer to Giglio Islands, turning off ship radar and navigation
Captain decreases speed while he eats dinner

21:39
To compensate for lost time, the Captain increases speed to 16 knots during sail-by of Giglio islands
Captain eyeballs distance from shoreline, despite having left glasses in cabin
Officers on bridge fail to warn the Captain of their concern

21:44
Captain gives order to helmsman to "port 20" (twenty degrees to the left)
Helmsman incorrectly turns the rudder "starboard 20" (twenty degrees to the right)

Crash
21:45



Costa Concordia
Other factors leading up to the event

- Cruise ships passing popular destinations often deviate from planned routes to accommodate passenger requests to sail closer to land (known as a 'sail-by')
- Investigation revealed that the company put "passenger entertainment" ahead of mandatory safety instructions
- Crew were using unauthorized maritime charts
- Captain had turned off the ship's computer navigation system but even if it had been turned on, it was not calibrated properly and would not have prevented the collision
- Officers on bridge failed to warn the Captain about their concerns of the ship's speed. Interviews during the investigation revealed that crew members were not comfortable challenging the commanding officers. They had been trained not to question orders.
- Captain was on the bridge with a "romantic partner", a non-paying passenger
- Traces of cocaine were identified in the Captain's hair following the incident

Events following the crash

Crash
21:45

Immediately following the crash
Emergency generator powers on for 41 seconds before failing. All officers make their way to the bridge.

21:51
Captain is informed that engine rooms are flooded and power has been lost. Captain makes passenger announcement stating there is a “blackout” and the situation is “under control”. Captain contacts ship owners to tell them the ship has struck a rock.

22:07–22:22
Ship contacted by local harbour master, Captain reports a blackout and describes the situation is under control.
15 minutes later, Captain contacts local harbour master to request two tugs. He reiterates that situation is under control and makes no mention of a breach.

22:33
General emergency alarm raised, passengers directed to muster stations.

22:54
Captain gives abandon ship order in English only.

23:19
Captain abandons ship leaving Second Master to coordinate evacuation.

23:32
Second Master abandons ship with 300 passengers still on board.

Lessons learned

- **Promote and reinforce desired corporate culture**

  Even the strongest of controls cannot overcome bad culture

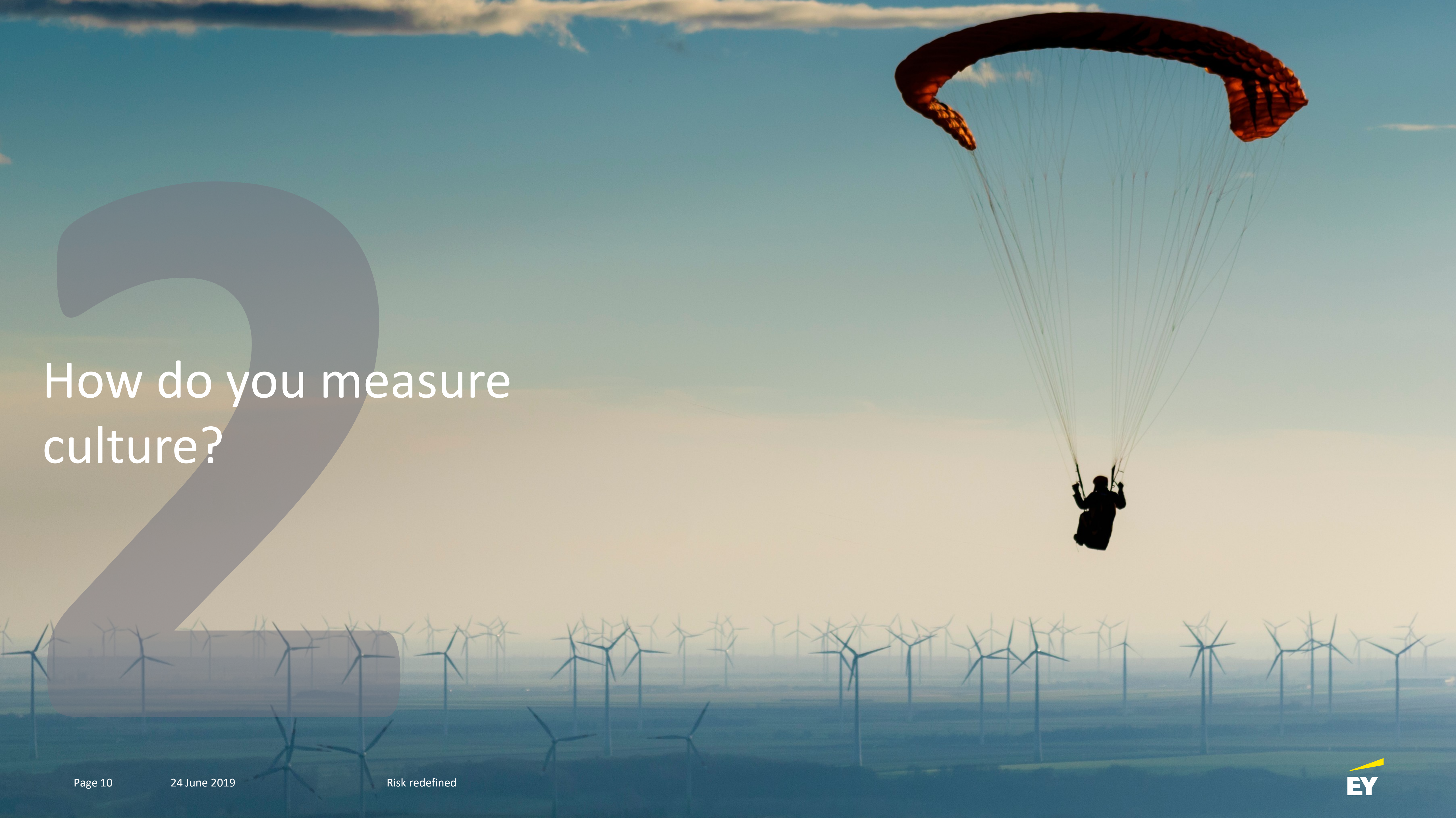
  Culture impacts conduct and conduct impacts culture

- **Positive assurance is better than negative assurance**

  Seek evidence of good culture instead of relying on attestations and other forms of negative assurance

- **Risk management effectiveness must be measured by outcomes**

  An ineffective risk management program is the same as no program



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How do you measure culture?

Known-Unknowns

"We know there are some things we do not know"

Donald Rumsfeld

Known-Knowns

"There are things we know we know"

Donald Rumsfeld

Unknown-Unknowns

"The ones we don't know we don't know"

Donald Rumsfeld

Unknown-Knowns

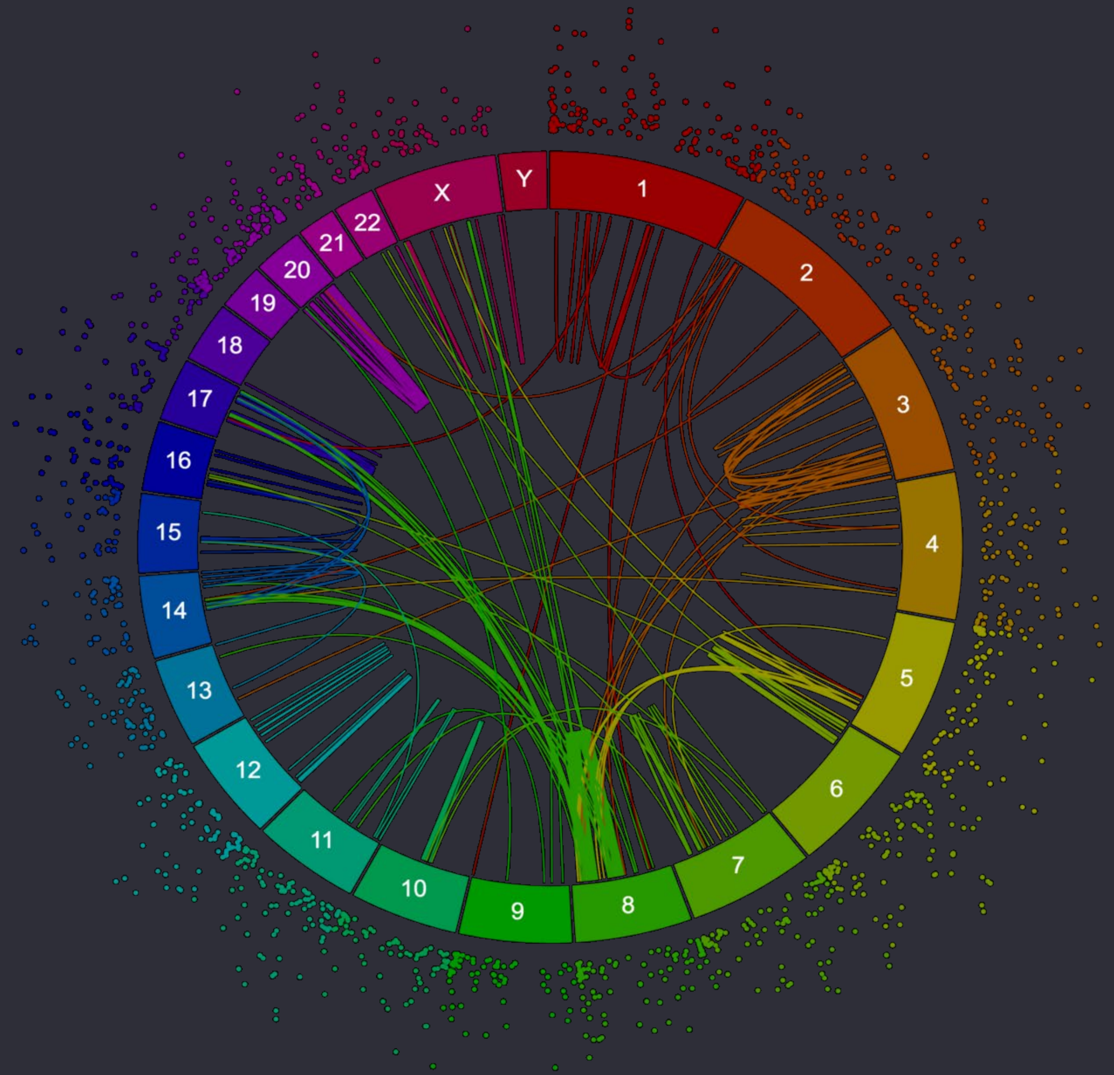
"That which we intentionally refuse to acknowledge that we know"

Slavoj Zizek

Acknowledgment: Low – High

Knowledge: Low – High

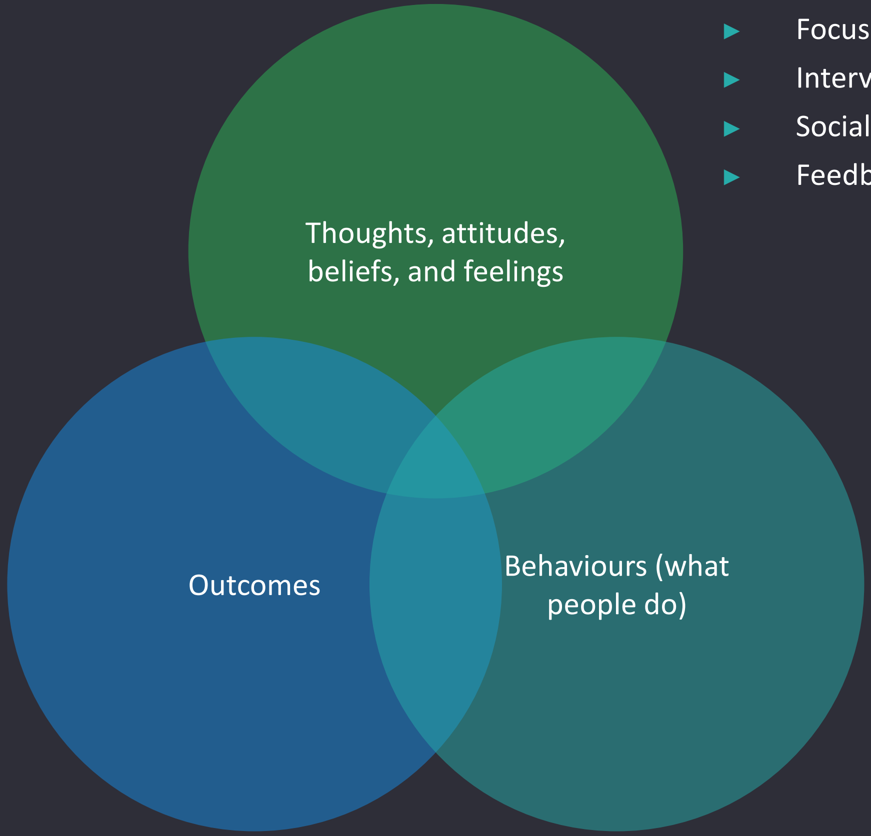
To understand culture, you must understand the organizational genome



To understand the organizational genome, you have to examine it from all angles

To examine the organizational genome from all angles, you need visibility into the three core cultural indicators

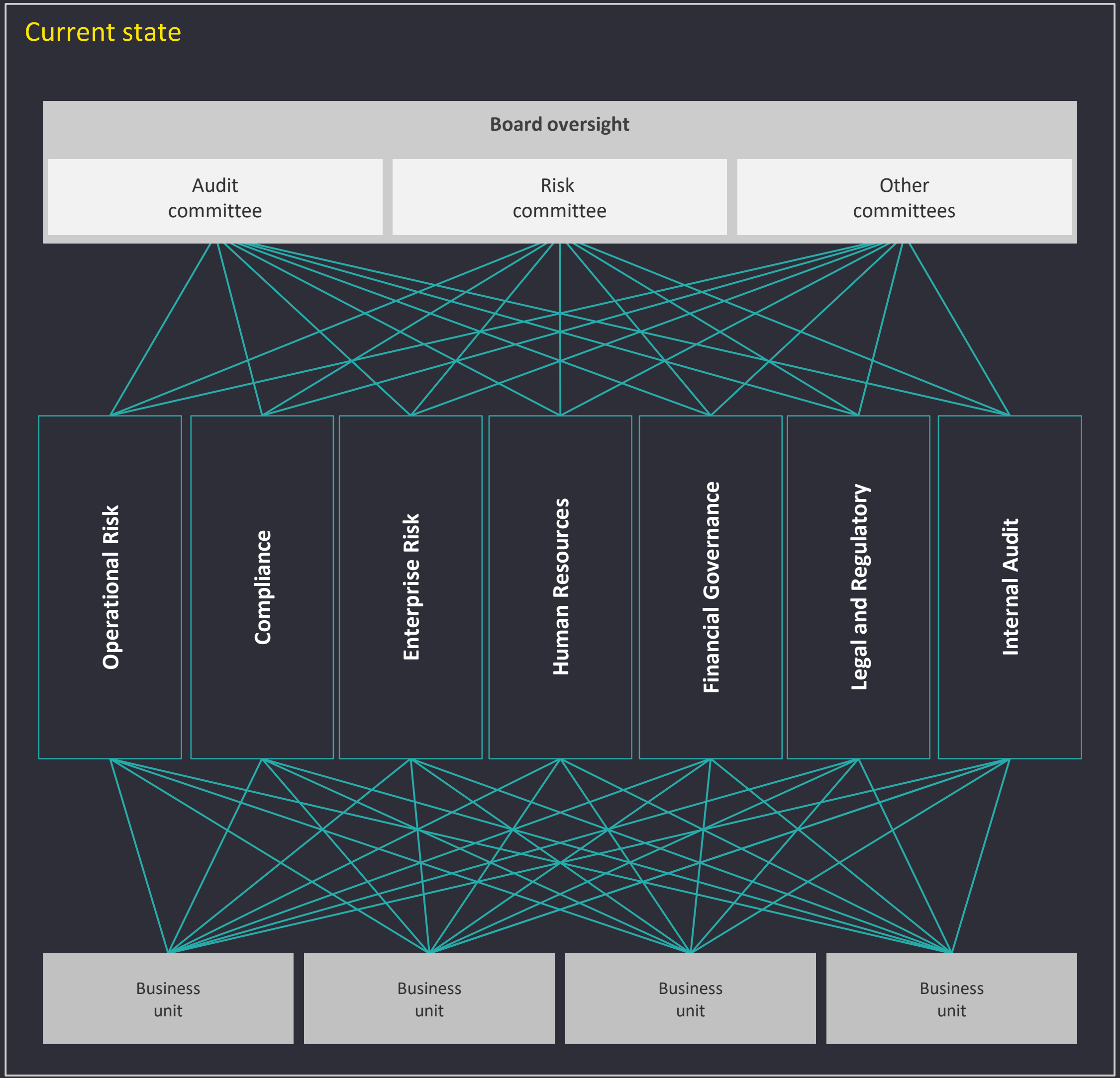
- Employee surveys
- Focus groups
- Interviews
- Socialization and networking
- Feedback, complaints and grievances

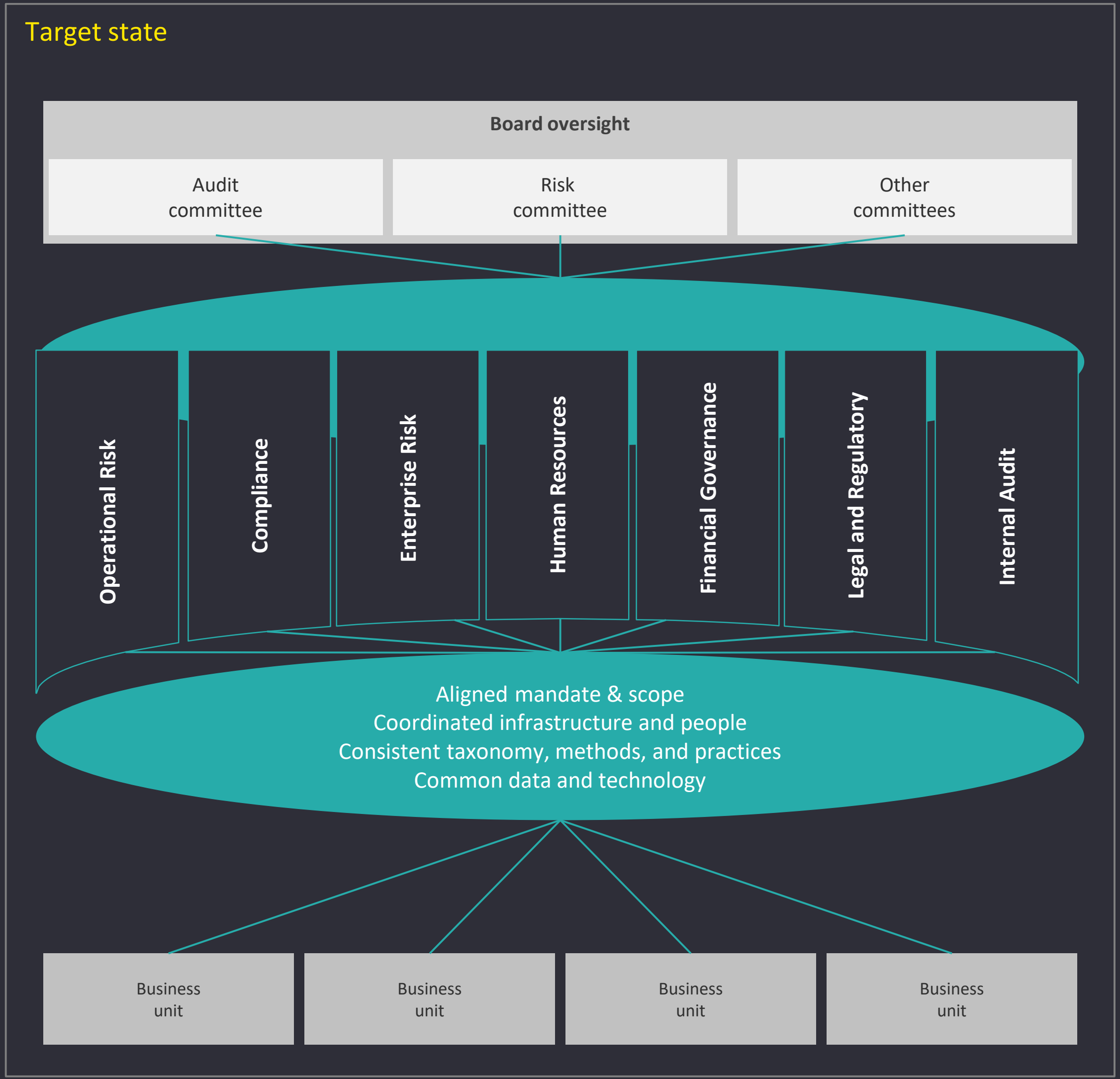


- Loss data
- Incidents and events
- Financial results
- Quality assurance reviews
- Performance reviews
- Customer feedback
- Key indicators

- Monitoring and surveillance
- Root cause analysis
- Performance reviews and compensation
- Risk assessments
- Internal audit reviews
- Complaints
- Whistleblower program
- Simulation exercises and testing
- Training and development

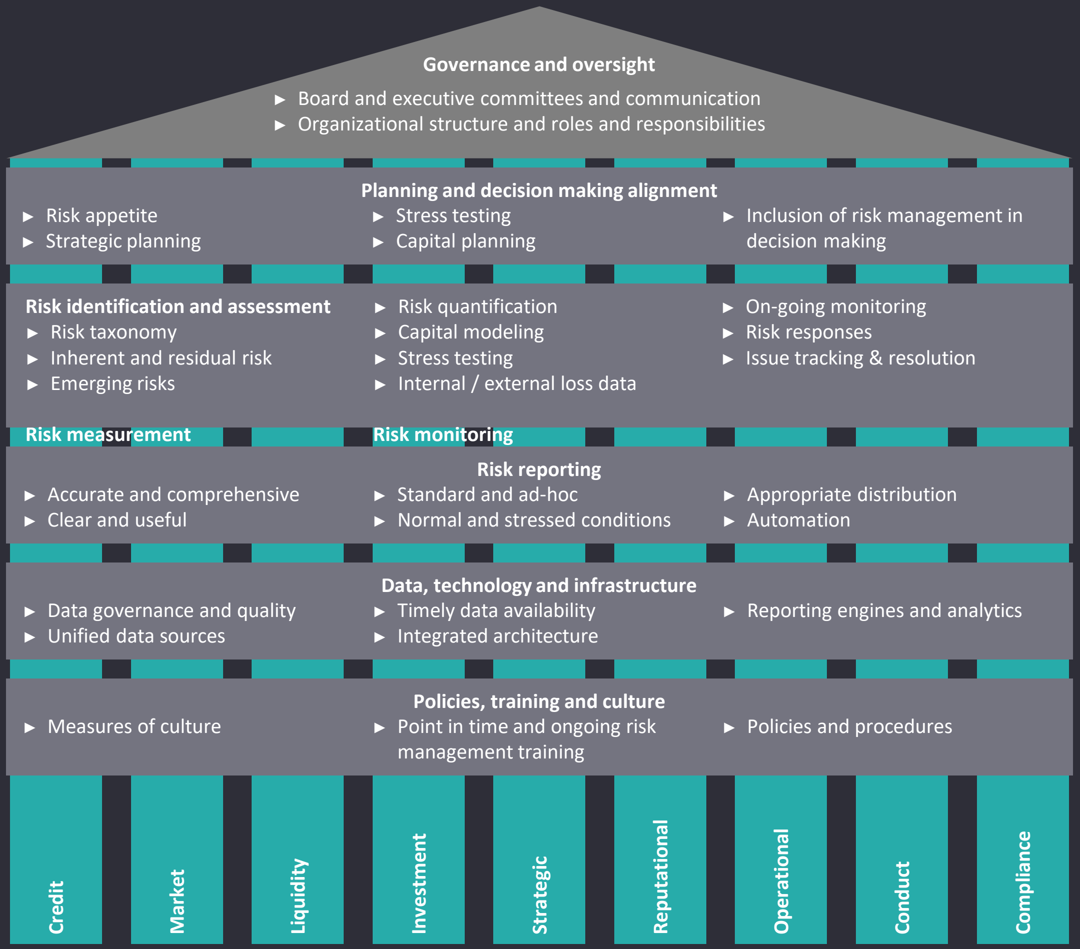
To examine the organizational genome from all angles, risk integration is key





3 Strategic insights & leading practices

Enterprise Risk Management Framework



Guiding principles behind a strong risk management framework:

- Risk appetite set by the board and part of a strategy that is established across the enterprise and embedded through individual limits, tolerances and performance assessment
- Driving risk-return through linking risk appetite and the ERM framework to strategy, new product design, capital allocation and performance measurement
- Firm-wide assessment of risks across all risk types including emerging risks and strategic risks, as well as a robust assessment around new products / business
- Consistent criteria for assessment with quantification at a range of confidence levels with models driven by common risk drivers
- Common risk language across the organization that reduces ambiguity and boundary issues
- Supported by timely, consistent and accurate management information (“single version of the truth”) that can be linked to demonstrable control activity based on well understood appetite and tolerance

For a culture framework to be effective, there are 5 "enablers" that must be effectively in place and working together

Culture enablers

Leadership: tone from the middle is aligned with tone from the top and desired behaviors are established and role modeled.

Organizational structure: risk governance and operating model support the delivery of desired behaviors and enable strong accountability and effective challenge.

Risk management framework: risk management framework is embedded in the way the business manages risk and enables effective challenge.

Organizational capability: lessons are learned and root causes are addressed. Constructive collaborative behaviours are expected and measured.

Talent management: employee life cycle and incentives are aligned to risk appetite and reinforce the delivery of desired behaviors.

Changes underway to tackle culture and its impact on conduct

Financial services firms face a sea of change in how they approach risk governance, manage the risk of misconduct, and foster a strong culture and in turn incentivize the desired and appropriate risk-taking behaviors

Yesterday's thinking		2020
▸ Strong focus on tone at the top, corporate values ▸ Strengthened codes of conduct, whistle-blower mechanisms ▸ Dependence on broad-based annual employee engagement surveys to measure or monitor culture	**Leadership**	▸ Strong focus on tone in the middle and at the bottom, clearly defined desired risk behaviors ▸ The culture must be proactive and everyone – board, senior and middle management, individuals – understand that they have a responsibility for their own behavior and to proactively report unacceptable behavior of others
▸ Roles and responsibilities are dependent on the assumption that everyone understands their roles and responsibilities within and across the three lines of defense ▸ Strengthened codes of conduct, whistle-blower mechanisms ▸ Dependence on broad-based annual employee engagement surveys to measure or monitor culture	**Organizational structure and capability**	▸ Broader set of mechanisms that influence and reinforce behaviors ▸ Systematic and integrated approach to measuring and monitoring culture ▸ Periodic use of focus group/interview techniques to probe for inconsistencies in behaviors ▸ The right stakeholders are at the table to evaluate the risk implications on an end-to-end basis of strategy and business decisions across the value chain, product lifecycle, marketing, client segmentation, pricing and remuneration ▸ More frequent health checks and monitoring through use of composite indicators
▸ Financial risk metrics in place, though some are backward-looking ▸ Nonfinancial risk metrics are limited in maturity ▸ Focus is on documentation and compliance	**Risk Framework**	▸ More robust non-financial risk appetite frameworks that are embedded in every element of the risk management framework ▸ New skill sets focused on data mining and analytics ▸ Human-centric approach to design of risk management frameworks ▸ Consequences are defined and rolled out when risk appetite and tolerance limits are breached
▸ Strong focus on financial incentives ▸ Some limited focus on behavioral metrics in advancing employees up the organization	**Talent management**	▸ Strong focus on financial and nonfinancial incentives ▸ Recruiting, on-boarding, exiting are designed to ensure that people who work for the firm share its values and desired risk culture ▸ Professional development of expected risk behaviors is available and taken

EY can help your organization with its risk culture journey

Defining the ambition

- Support for boards and senior management teams to define their risk culture objectives and the target conduct principles, values and behaviors that will promote a sound risk culture
- Enhancements to governance and accountability frameworks for setting, promoting and overseeing culture
- Establishing the essentials of effective risk reporting and escalation on behavioral and conduct matters
- Embedding effective culture and conduct risk measures into performance management

Risk culture assessment

- Multidisciplinary approach leveraging an experienced team of risk, regulatory and behavioral psychology professionals
- Proven methodology balancing quantitative data with qualitative assessments through a range of interview and focus group-based sessions to ensure a deep understanding of the drivers of risk culture and how these vary across the organization
- EY's market-leading research-backed analytics and diagnostic tool that focuses on behavior, culture and ethics and analyzes where these spheres are benefiting or hindering your risk and compliance objectives

Culture change programs

- Bespoke and fully integrated culture transformation programs that are actionable and measurable, focusing on governance, communication and training initiatives addressing:
  - Leadership capabilities and getting "tone from the top" right
  - Strengthening and aligning "tone from the middle"
  - Consolidating risk governance and accountability
  - Aligning the talent life cycle to risk, compliance and conduct objectives
  - Culture and conduct metrics and dashboards to track and monitor progress over time

Questions?