Joint IFoA and IRM Response to the FSB Consultation on Increasing the Intensity and Effectiveness of Supervision

The Institute and Faculty of Actuaries and the Institute of Risk Management are pleased to offer a joint response to the FSB's consultation on this important subject.

About the Institute and Faculty of Actuaries

The Institute and Faculty of Actuaries is the chartered professional body for actuaries in the United Kingdom. A rigorous examination system is supported by a programme of continuous professional development and a professional code of conduct supports high standards, reflecting the significant role of the Profession in society.

Actuaries' training is founded on mathematical and statistical techniques used in insurance, pension fund management and investment and then builds the management skills associated with the application of these techniques. The training includes the derivation and application of 'mortality tables' used to assess probabilities of death or survival. It also includes the financial mathematics of interest and risk associated with different investment vehicles – from simple deposits through to complex stock market derivatives.

Actuaries provide commercial, financial and prudential advice on the management of a business' assets and liabilities, especially where long term management and planning are critical to the success of any business venture. A majority of actuaries work for insurance companies or pension funds – either as their direct employees or in firms which undertake work on a consultancy basis – but they also advise individuals and offer comment on social and public interest issues. Members of the profession have a statutory role in the supervision of pension funds and life insurance companies as well as a statutory role to provide actuarial opinions for managing agents at Lloyd's.

About the Institute of Risk Management

The Institute of Risk Management (IRM) is the world's leading enterprise-wide risk education Institute. We are independent, well-respected advocates of the risk profession, owned by practising risk professionals. IRM passionately believes in the importance of risk management and that investment in education and continual professional development leads to more effective risk management. We provide qualifications, short courses and events at a range of levels from introductory to expert. We support risk professionals by providing the skills and tools needed to put theory into practice in order to deal with the demands of a constantly changing, sophisticated and challenging business environment. IRM operates internationally, with over 4000 members and students in more than 100 countries, drawn from a variety of risk-related disciplines and a wide range of industries. IRM qualified member grades (MIRM, CIRM and SIRM) are recognised worldwide as the sign of a qualified risk management professional and are achieved through examination and recognition of relevant prior learning. Fellowship (FIRM) follows through accredited practical experience.

Overall

The IFoA and the IRM acknowledge the difficulty facing the FSB in seeking to monitor and regulate something as intangible as the risk culture of a firm. We welcome the FSB's guidance on how to improve their risk culture and taking the first steps to steer the corporate culture more towards a risk culture.

We hope that our comments will go some way to helping the FSB to develop its thinking in this area and welcome future dialogue with the FSB on the topics raised.

We recognise that capital adequacy has, in the past, been considered as the key for controlling damage of excessive risk taking by financial institutions. We welcome the acknowledgement through this document that 'capital adequacy' cannot control institutions from excessive risk taking and welcome the focus on the surrounding behavioural issues that manipulate the building of 'capital adequacy' (or factors).

We note that the document seems to focus on the cultural flaws of profit chasing that arose from the recent crisis and caution that this may not be addressing all the cultural issues that might arise in the future.

The key points we would like to make to the FSB in respect of this consultation are as follows:

1. We would ask the FSB to clarify its definition of the term risk. We also note that there is a good case for not defining risk and highlight that caution should be exercised in using the classical economics definition of risk.
2. We encourage the FSB to consider whether it can set out to supervise a firm's risk culture without also involving itself in many issues of the firm's corporate culture. Should the FSB decide this necessary, we would encourage the FSB to more clearly define risk culture and corporate culture, clarifying the differences.
3. We suggest structural and behavioural indicators that could be indicative of the (risk) culture of an organisation:
    a. Structural indicators:
        i. Organisational Structure
        ii. Policy / Guidance Structure
        iii. Board Minutes
        iv. Regular communication of "near misses" and "lessons learned lists"
        v. Training / Coaching Structure
        vi. Human Resources Policies / Procedures
    b. Behavioural indicators:
        i. Communication Quality
        ii. Decision Making Quality
        iii. Learning Ability of the Organisation
4. We highlight the difficulty for individuals immersed in a culture to assess the culture they are embedded in. We consider this difficulty of observation as crucial to account for in any attempt to assess (risk) culture.
5. Supervisors should perhaps reflect on whether they are the most powerful influencers of (risk) culture and whether there are additional more suitable ways the public sector could improve the (risk) culture of organisations.
6. We highlight the need to be aware of the various corporate cultures that supervisors will encounter; and to be aware of the supervisory culture in making assessments. We also highlight the need for a proportionate assessment that takes account of the organisation's size, geography and complexity.
7. We encourage engagement with social scientists (such as social anthropologists) to help with the assessment of (risk) culture.

8. We caution against intervention in setting the strategic direction of organisations and encourage supervisors to consider how they will use the information they collect on (risk) culture.
9. We encourage the FSB to ensure that due attention is paid to non-financial risks as well at the financial risk; especially as these can be more relevant at different levels of the organisation and can cause or be catalysts for financial risk events occurring.
10. We have suggestions for the ways in which a sound (risk) culture can be embedded, these include:
    a. Accountability
    b. Speaking-Up / Upward Communication
    c. Clarity of Purpose
    d. Clarity of Acceptable / Unacceptable Behaviour
    e. Risk Sensitive Incentive Systems
    f. Recruitment / Induction

For the detailed responses to the specific questions that the FSB is asking we have grouped the FSB questions according themes, please see Annex A.

Should you wish to discuss any of the points raised in further detail please do hesitate to contact Paul Shelley, IFoA Policy Manager (paul.shelley@actuaries.org.uk; or 079 1760 4985) or Carolyn Williams, IRM Technical Director (carolyn.williams@theirm.org; 020 7709 0716).

Yours Sincerely

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Richard Anderson
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Annex A **Detailed Responses**

Are there areas not addressed in the Guidance that should be considered in assessing risk culture? *Are there areas of the Guidance where further elaboration or clarity would be useful, without becoming too granular?*	In this section we address the two questions on the content coverage and depth of the paper. We suggest that the FSB considers the inclusion of '*risk communication'* within this paper as getting information on risk quickly to where it is needed for decision making and organisational learning is a key area of guidance.
Are there useful descriptors of an institution's risk culture, both good and bad, that would be helpful to include in an attachment to the paper? For example "growth for growth's sake.	[We do not have a response to this question.]
Would the Guidance benefit from further elaboration on the definitions of corporate culture, risk culture and sub-cultures within business lines, and on the relationship between them?	We welcome the role the term *risk culture* has had in encouraging debate on the way that risk-taking interacts with corporate culture; however, we suggest that the lack of a clear definition still creates cause for confusion. In this section we explain our concerns but thereafter in our responses we use the term *risk culture* according to the IIF definition that the FSB used in the paper. The following comments are therefore intended to help the FSB consider whether and how it should continue to use the term *risk culture* and if so whether and how it should be defined. **IIF Definition** We understand that the FSB refers to the IIF definition of risk culture as *"the norms of behaviour for individuals and groups within an organisation that determine the collective ability to identify and understand, openly discuss and act on the organisation's current and future risk."* ***Corporate Culture vs. Risk Culture*** We see merit in this description but struggle with the concept of this being *risk culture* as opposed to the *corporate culture*. It appears to us that this description refers to the application of the corporate culture to current and future risk taking. We understand the FSB is seeking to regulate the impact of corporate culture on decision making, and that risk and uncertainty should be taken into account. In this sense we consider risk culture to be embedded within, or just part of, the organisation's corporate culture. To understand this we suggest it is necessary to understand different corporate cultures that can exist and how risk and uncertainty are perceived within those corporate cultures. Therefore, we see the issue the FSB is seeking to address as being one of *risk perception from a given corporate culture* as opposed to trying to create '*a risk culture'*.

	To explain our position we start with our understanding of what a corporate culture is. Our concept of what constitutes a corporate culture comprises the following (non-exhaustive) list which we have sub-divided into Structural and Behavioural. *Structural* • Structures and systems • Processes • Goals • Practices *Behavioural* • Attitudes • Shared Values • Vision / Ideology • Relationships • Commitment • Language • Emotion • Stories / Narratives • Accepted behaviours • Rituals • Shared understanding If culture is to be defined we are of the view that this list (or an expanded version of this list) could be a more comprehensive way of defining a particular corporate culture. Alternatively a colloquial way of defining *corporate culture* may just be “the way we decide to do things around here”. We also note that there is a good case for supervisors **not** to define corporate culture or risk culture as it is still an emerging topic. This is because a regulatory definition could simply be hard-wired and adopted by firms who will not think about what *they* mean by *corporate culture* and *risk culture*. We would draw the FSB’s attention to the UK Financial Reporting Council which has been consulting on a similar topic over the same period.[1] If this idea is accepted by the FSB then we would encourage the FSB to require firms to publish what *they* mean by their corporate culture. From this stakeholders, including supervisors but also investors, could infer what the culture of the organisation was and appraise for themselves whether this was fit for purpose in respect of risk management. It might also be worth noting the distinction between defining the (risk) culture and taking a judgement on what is considered to be a *good* or

[1] The URL for the UK FRC consultation can be found at http://www.frc.org.uk/Our-Work/Publications/FRC-Board/Consultation-Paper-Risk-Management,-Internal-Contr.aspx. We are of the view that there is more research that can be undertaken in this area.

	right (risk) culture. In encouraging the FSB to require firms to publish what they mean by their (risk) culture and explaining how that culture manifests itself we are suggesting the judgement over what is a *good* or *right* (risk) culture sits with the stakeholder – one of whom is the supervisor. ***Definition of Risk*** Given the paper addresses *risk* culture we are of the view that it should not be taken for granted how *risk* is defined. We highlight there are different views on this and therefore some heterogeneity of definition is to be expected. We also reiterate that there is a good case not to define (risk) culture. One definition of risk we urge the FSB to be particularly wary of however, is the manner in which *risk* is mapped to a single number in the rational choice utility, maximising models of classical economics. We are of the view that understanding risks has as much to do with (and perhaps more to do with) psychology and anthropology as it does with quantitative analysis. In conclusion, we encourage the FSB to consider whether it should be defining corporate culture or risk culture. If the FSB decides this is necessary we encourage the FSB to more clearly define risk culture and corporate culture and draw out the differences in its document.[2] We also note that there is a good case for not defining *risk* and highlight that caution should be exercised in using the definition of risk in classical economics.
What tools would assist, in particular supervisors, to effectively assess the risk culture of financial institutions (e.g. interviews, questionnaires, analyses of internal documents such as board self-assessments, code of ethics for employees, risk appetite statements)? *Are the indicators identified in the Guidance*	There were a number of questions asked in respect of indicators of (risk) culture and assessment of (risk) culture. To us the assessment / measurement of (risk) culture and the indicators of risk culture are not easily separated. Therefore we have combined our responses to the questions that relate to risk culture measurement. We hope these will provide some useful perspectives for the FSB. The measurement of (risk) culture is, we recognise, a challenging task. Our work with anthropologists has taught us that the skills needed to appraise a culture do not easily lend themselves to the quantitative toolkits that risk managers in financial services have tended to use. We could imagine an inspection style assessment to experience culture over a few days. Indeed this is precisely how social anthropologists conduct their field work so it may be that encouraging or contracting

[2] We wonder if this has fallen into the trap of defining a new term for something that is really about good risk management, with the culture about delivery of this – there is a risk that the two have been confused.

sufficient for assessing risk culture and adequately capturing the multifaceted nature of risk culture? *Are there specific examples of good practices that can be used to support the indicators?* *Are the indicators identified in the Guidance commonly considered by the board and senior management when internally discussing risk culture? Are there other indicators that should be included?*	social anthropologists to deploy their skills would be a good innovation that the FSB could encourage. Culture is more difficult to recognise the more tightly embedded one is within that culture. This suggests to us that deploying observers such as anthropologists with a background from outside the financial services could be useful technique for uncovering the cultural dynamics. We suggest the indicators of culture fall into two categories: structural indicators, of the sort that could be undertaken by a desk top review of the firm's documentation; and softer behavioural indicators, that would require face-to-face engagement with the organisation ***Structural Indicators*** *Organisational Structure* • The management structure is an obvious first reference point, in that it represents the official version of the relationships inside the organisation. However, the true nature of the relationships within an organisation may be significantly different and therefore caution should be exercised in inferring that the official organisational structure represents the true organisational structure. We would argue that much of the effort in assessing the culture of an organisation lies in finding the de-facto organisational structure. • As we discuss later in this document, one of the features of an organisational structure in a sound (risk) culture is clarity and communication of roles and responsibilities. Therefore a management structure where the de-facto organisational structure differed markedly from the official structure *may*[3] suffer from a lack of clarity of roles and responsibilities and be an indicator of an unsound (risk) culture. *Policy / Guidance Structure* • Policy and guidance (particularly on decision making) can be useful in the development of a sound (risk) culture. However, we would note that many failed firms had extensive guidance and policy frameworks prior to failure; therefore, to be effective the policies must be embedded in the organisations and become a part of the culture of the organisation. • We note therefore that if policy / guidance is bypassed in the process of decision making then it is not effective and has failed in its purpose. The proof that policy / guidance has been adopted in the culture is when it is followed despite no-one looking over the shoulder (concurrently or retrospectively) of the decision maker. • We have the following suggestions for designing policies / guidance that will successfully become part of an organisations culture. o The policies and guidance need to have clarity and meaning to the staff members to whom they apply to in order to improve the chances of being adopted.

[3] We say *may* because the de facto roles and responsibilities may be clear to everyone in the organisation without necessarily being communicated in a document supplied to a desk top review.

	◦ Principles-based policy / guidance such as a code of ethics or a code of conduct can serve a useful purpose in making sure that decisions are made in the correct spirit rather than holding decision makers to a set of hard rules. This reduces the chances that the code needs to be bypassed in order to make practical decisions in a business environment. The UK Corporate Governance Code issued by the UK Financial Reporting Council is a good example of a principles-based code that boards are expected to comply with. ◦ Involve decision makers in the design of policy / guidance to ensure that they buy-into the policy / guidance. While policy can be forced onto decision makers by senior management / internal audit, this is unlikely to have a positive effect on the (risk) culture and may even have an adverse effect. *Board Minutes* • Board minutes are another structural indicator. We note that there is a trend for supervisors to require board minutes are shared with them as part of the supervisory review process. We note that willingness to provide board minutes to a supervisor, which evidence both challenge and consideration of risk issues, is an indicator of a sound (risk) culture. However, we caution that in an unsound (risk) culture this requirement could create a cultural norm of not discussing issues in the boardroom that *should* be discussed in the boardroom. *Training / Coaching Structure* • We see a training / coaching programme as being an important indicator, in particular training / coaching those with decision making authority. The training should not be a one way flow of information to the employee. Rather, we suggest that training / coaching should be a two way flow of information as this is crucial to establishing policy / guidance that will be accepted by the decision makers in the organisation. • The outcome of the training (and coaching) should not only be that the policy / guidance is understood but also that it is *accepted* by the decision makers as a valid instrument that is worthwhile of adherence. The danger with training without a feedback mechanism is that policy / guidance is not truly accepted by the trainee but that the training schedule is completed and the right answers are recorded as having been given. • The leadership of the organisation have a crucial role in endorsing the training / coaching both publicly and privately to encourage its acceptance. For example, if ex-post success is always rewarded regardless of the scale of the risks that were taken to achieve that success, then policies or codes designed to prevent such risk taking will prove ineffective. • Research[4] suggests that the problems of risk communication fall within the scope of the following list of topics so we would suggest these form the basis of an effective training programme and therefore

[4] Research from the National Academy of Science - see references towards the front of the document.

	serve as a indicator of a sound (risk) culture: o Establishing and recognising credibility o Making the messages understandable o Preparing messages in an emergency o Capturing and focusing attention o Getting information *Human Resources Policies / Procedures* • The performance management structure of an organisation is another area where structural indicators of (risk) culture could be found. We will not say a great deal about this topic as we are sure that the FSB are well aware of the issues. • We also suggest that diversity in the workforce (management and employees) both in terms of nationality, race and colour; gender; age; profession; and academic discipline can have beneficial effects on the culture of an organisation. Our reasoning is that by bringing different cultural perspectives to bear it is easier to expose the cultural traits of an organisation. **Behavioural Indicators** Below we set out some of the less tangible indicators of (risk) culture that we would not necessarily expect to find written into the policies and procedures of a firm but can provide a useful indicator of the risk culture of the organisation. *Communication Quality* We observe that historical failings of culture are often risks that were not considered for discussion and therefore not modelled nor included in the scenarios that firms tested themselves against. In cases where a risk was not considered despite at least one person within the organisation being aware of the risk, we suggest that a failure to communicate internally within the organisation was a significant contributory factor. Where a risk was not known to anyone within the organisation we would suggest that the organisation was not communicating effectively externally, for example with its extended organisation. As mentioned later in our response, we are of the view that a sound (risk) culture is able to quickly communicate bad news upwards through the organisation to the decision makers. In this way the organisation is made transparent to the decision makers, this in turn helps to create a learning organisation. For example, the regular reporting of “near misses” accustoms senior management to receive bad news without bad consequences, and is a sign of good risk communication. Communication of the roles and responsibilities is also an important indicator of a sound (risk) culture as mentioned earlier in our response. Finally, the effective communication of the ethics and values of the organisation by the business leaders is an important indicator of a sound

(risk) culture.

Decision Making Quality

When we consider what can impair good decision making within an organisation we come up with what might be considered rather low level and soft indicators of (risk) culture. While this may be at a more granular level than the FSB intends with their document, we suggest these are worth consideration as they can be quite powerful in assessing the culture. We have called these *Habitual Indicators*.[5]

Habitual Indicators (not exhaustive)

- How meetings are chaired e.g. is everything on the agenda given suitable time
- How busy decision makers are – is there enough time to think between complex issues i.e. is it acceptable to fly from one big decision to another?
- How are action logs managed through various governance forums – is it acceptable to be late on an action, do actions get regularly deferred, do actions get closed and a new action reopened?
- How acceptable is it for late starting of meetings and general meeting room etiquette (using BlackBerries).
- Quality, comprehensibility, and accessibility of documentation on business models including technical documentation.

We highlight that decision making within an organisation often takes the form of heuristics which can be positive indicators of a good (risk) culture if they are risk-sensitive. When quick decisions need to be made, an elaborate risk model can often be a hindrance to good decision making or even cause dangerous delays. As a result, the lack of use of complex models should not be seen as an indicator of a poor (risk) culture if risk-sensitive heuristics are used instead.

Learning Ability of the Organisation

We see a key indicator of a sound (risk) culture as the ability of a firm to demonstrate how the organisation has learnt from mistakes[6] and adapted to learn from these.

We consider a key element of a good learning culture is the ability of an organisation to admit its mistakes and failings. Organisations which cannot do this are at risk of having a rigid culture that cannot adapt to changing circumstances.

When problems do arise an important indicator is how effectively these are escalated so that management are aware of the issues and can help the organisation learn from them. Barriers to escalation, such as a 'blame culture' can inhibit communication upwards through the firm and therefore impede the learning culture of the organisation.

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[5] Some of these indicators also affect the quality of communication in the organisation, however for the purposes of expediency we have grouped them together under the decision making quality sub-section.

[6] We would argue that this is underplayed in the document (noting that learning is mentioned on page 6).

	One useful indicator might be how a firm deals with employees that have experienced / reported a failure. A habitual reaction that involves the dismissal of employees might be indicative of an enterprise that cannot recognise its own systemic shortcomings. Therefore, high staff turnover, especially sudden changes to staff turnover in a short period of time, can be indicative of a poor (risk) culture. An important tool for fostering a learning organisation could be to undertake a retrospective review of decision making and assumptions used in running the business. Potential areas of focus for a retrospective review: • How decisions are made, the degree of challenge (from executives as well as non-executives) to decisions and how challenge was resolved. • How well a business case was delivered irrespective of whether it was successful or not. • How well expert judgements that were used in setting assumptions / designing models / decision making performed in retrospect. • How approximations that were assumed reasonable fared in retrospect. We suggest that such an assessment has benefit for individuals in an organisation to improve their decision making and assumption setting. We do **not** however, see this being of benefit if the assessment is used to take individuals to task for failing to predict an uncertain outcome. Such an assessment could also be a useful tool for regulatory assessment of culture and for the firms themselves.[7] In particular, evidence of the regular publication of a “lessons learned lists” would be a good indicator. An additional tool for assessing a risk culture is expressed in the IRM's ‘Risk Culture Aspects’ model[8]. This covers many of the same concepts as outlined above but organises the assessment, into the following subject areas and gives detailed guidance for each: • ‘Tone at the top’- risk leadership and dealing with bad news • Decision-making – informed risk decisions and the link with rewards • Governance – accountability and transparency • Competency – resources and skills in respect of risk management The IRM's guidance also gives some practical, project management based direction in respect of getting started on a risk culture assessment and change programme. In conclusion, we have suggested structural and behavioural indicators

[7] Ultimately this work should provide business value and can be used to demonstrate/evidence operational risk capital requirements, with good risk culture feeding into lower capital requirements.
[8] As published in ‘Risk Culture: Resources for Practitioners, IRM, 2012

	that could be indicative of the (risk) culture of an organisation. The structural indicators are: • Organisational Structure • Policy / Guidance Structure • Board Minutes • Regular communication of “near misses” and “lessons learned lists” • Training / Coaching Structure • Human Resources Policies / Procedures The behavioural indicators are: • Communication Quality • Decision Making Quality • Learning Ability of the Organisation We also highlight the difficulty for individuals to assess the culture they are embedded in. It is important to account for this difficulty of observation in any attempt to assess (risk) culture.
What is the expected supervisory response if, for example, the board of directors failed in its responsibility of setting the adequate tone from the top and consequently in promoting a sound risk culture? *What suggestions do you have to improve the engagement of supervisors with financial institutions on risk culture, in particular when discussing the underlying causes of behavioural weaknesses?*	In this section we outline our response to the questions the FSB has asked in respect of the role of supervisors. We have split our comments into the assessment of current (risk) culture and the steering of future (risk) culture. **Assessment of Current Risk Culture** While we appreciate that supervisors have access to privileged information, we are not of the view that supervisors are “in a unique position” to provide views and assessments of culture. Partly, as supervisors are often not close enough to the business decisions and partly as supervisors can tend to base views on desk top reviews or interviews, from which, it would be hard to form a complete and unbiased view on the corporate culture as we describe earlier in our response. We suggest site visits to investigate whether values are embedded throughout the firm are necessary to make a proper assessment of the current culture. This may require external advice from those with expertise in observing behaviour and cultures, such as an anthropologist. **Steering Future Risk Culture** *Investors or Supervisors* We acknowledge that supervisors have a strong interest in the role of (risk) culture as it affects prudential supervision, conduct of business supervision and systemic risk supervision. However, we would highlight that it is also crucial for investors to indicate their disapproval should the culture of an organisation threaten their investment. It may be argued that the investors’ interest is actually stronger given they stand to lose their investment before policyholders are adversely affected. We note the corporate social responsibility that investors demand of firms

	could be a useful tool in steering the culture of organisations. We also note that the wider public sector has significant money to invest through public sector pension schemes, or indeed through the tax incentives offered through saving vehicles. Therefore the public sector has other, potentially more potent levers, for improving the (risk) culture of organisations that can complement the supervisory route. *Supervisory Framework* Accepting the premise that supervisors will seek to regulate (risk) culture, we set out below our response on how a supervisory framework might look. We caution that a supervisor will need to ensure they use a framework that makes allowance for the plurality of cultures that they will encounter. Supervisors will need to recognise their *own* cultural bias and make efforts to allow for this when assessing the (risk) culture of organisations. With reference to the work of social anthropologists who developed the cultural theory of risk, we note that there is likely to be a *supervisory* culture that is unlikely to be apparent to the supervisors themselves. We suggest that suitable training should be provided to assist supervisors with this. We have found engagement with anthropologists useful in this regard. When engaging with organisations we would encourage supervisors to maintain an open dialogue, not just with the people that lead the firm, but with the people below senior management too. When producing a report on the (risk) culture of an organisation we would encourage supervisors to focus on a complete picture of the (risk) culture; describing the good as well as the less good features. *Proportionality* Developing a sound (risk) culture can be costly and time consuming. For example, developing a policy framework with the decision makers rather than imposing on them, while vital, is inevitably more time consuming. We are therefore **not** of the view that there are quick fixes which supervisors can enact, this will need to be built into the plans of the supervisors. We would also highlight that (risk) culture could be proportionate to the size, geography and associated business complexity of the organisation. Larger organisations usually have and require more extensive corporate governance and internal control; and consequently *can* end up with a lower risk appetite[9], although the capacity to create greater disruption when things go wrong is amplified.

[9] We note that this is not necessarily the case as the risk appetite depends on the attitude to risk of the decision maker.

Smaller organisations may lack such extensive corporate governance and internal control, but may have much better internal communication that helps risks be communicated rapidly around the organisation.

We caution that the willingness to produce documentation for the supervisor should not of itself be considered indicative of a good risk culture.

We see that the FSB is sympathetic to the idea that a sound (risk) culture needs to pervade the organisation with references to “all staff” for implementation of training and risk management understanding. While we understand this reference, we suggest avoiding wording that creates an excessively disproportionate burden on firms where a tighter focus on the decision makers in an organisation would achieve the same outcome.

We support that regulatory action should be firmer and more invasive if an organisation persistently demonstrates a poor (risk) culture and is not prepared to undertake remedial action.

Supervising the Business Model / Strategy

We note there is a reference to “prudent risk taking” (3.1.8) and we highlight that, taken literally this could seek to define a business model for the regulated enterprise. We are not of the view that supervisors should be entering the area of strategy formation. Our reasons include:

- Supervisors having inside information across a number of firms could be problematic for the supervisor itself.
- There is a danger that the supervisor is steering the strategic response of the sector which will impede the innovation of the free market in goods and services.

We suggest that this section could benefit from further clarity.

Supervising Financial Stability

We can see a role for supervisors in *monitoring* the business models from a financial stability perspective. If for example, many large firms adopt the same business model and corporate culture, it may cause an increased risk to the stability of the financial system.

The response, however, will depend on the nature of the systemic risk. Similarly to within the organisations themselves, the public sector will need good quality communication of risks and the ability to learn from failures. In a global financial market *government* effectively means the G20.

We urge the FSB and supervisors to consider what they will do with the evidence of (risk) culture that they collect (i.e. how and to whom they communicate the risks they perceive and what course of remedial action they might recommend).

We caution against seeking to impose a single “risk culture” on all

	organisations. Our reasoning is that by forcing all organisations to act in a similar way supervisors can make the financial system more fragile and *increase* financial instability. We highlight that heterogeneous approaches to risk and hence heterogeneous (risk) cultures are necessary to make the financial system more resilient. We refer to the work of Holling (see references) for more details. In conclusion, we suggest that supervisors could reflect on whether they are the most powerful influencers of (risk) culture and whether there are additional, more suitable ways, the public sector could improve the (risk) culture of organisations. We highlight the need to be aware of the various corporate cultures that supervisors will encounter and to be aware of the supervisory culture in making assessments. We also highlight the need for a proportionate assessment that takes account of the organisations size, geography and complexity. We encourage engagement with social scientists (such as social anthropologists) to help with the assessment of (risk) culture. We caution against intervention in setting the strategic direction of organisations and encourage supervisors to consider how they will use the information they collect on (risk) culture.
Does the paper appropriately describe the different roles of the board, senior management and other control functions in relation to defining, implementing and monitoring risk culture? *What tools or processes are used to make risk culture tangible within the organisation?*	In this section we answer those questions on the role of an organisations management on its risk culture. Our comments address the roles of different levels within the organisation and suggest some ideas for embedding risk culture in the organisation. **Risk Management at Different Levels of the Organisation** We agree that culture will start with the board and senior management and that the board should take ownership of the (risk) culture, as their personal success and the business success are closely tied to it. We suggest that the board and senior management also have an important role to play in a sound (risk) culture by providing committed leadership and communicating the ethics and values of the organisation through their actions. We note also that the (risk) culture cascades down through the organisation, not just in the risk management function, with risks needing to be owned by the business lines where the means to control the risks lies. Therefore, we see a sound (risk) culture as being one that pervades the organisation in the form of *committed leadership* at all levels, not just behaviours of the board. We note that the top 10 risks for the board may well be different from the top 10 at business unit level and different again at the process level. Therefore the nature of the risk and the perception of the risk may

change substantially at different levels of the organisation. In particular, what is a clear financial risk at the board level can be driven by something that is non-financial at other levels of the organisation. For example, trading losses could ultimately stem from a poor human resources function that might have been indicated by a rise in the staff turnover or sickness rate.

Therefore, while we acknowledge that financial institutions have a culture norm that places a great deal of emphasis on financial risk management. We would urge the FSB to support that it is not just financial risk but also the non-financial risks that need to be considered as these are often the cause or a potent catalyst for financial risk to emerge.

The tools for analysing non-financial risks are often qualitative and require skills in social sciences, which could challenge some of the cultural norms of financial services firms.

Finally in this section, we note that the size of the organisation has an influence on how effectively the (risk) culture cascades down to the different levels.

Techniques for Embedding Risk Culture

We have set out below some suggestions for how a sound (risk) culture might be developed. Our list is by no means exhaustive.

- Accountability
  - In particular a clarity of roles and responsibilities to avoid invisible or ambiguous roles and responsibilities developing.
- Speaking Up / Upward Communication
  - To ensure that it is possible to send information on risks upward through the organisation and enable it to learn. Whistle blowing is a last resort failsafe device which some staff may be reluctant to use. A better approach might be to develop mechanisms for staff to speak-up and hence provide a conduit for risk information to flow upwards where the concern of the staff member is not as acute as to require the whistle blowing failsafe.
- Clarity of Purpose
  - To ensure that strategic objectives are clearly articulated and communicated and avoid invisible or ambiguous strategic objectives.
- Clarity of Acceptable / Unacceptable Behaviour
  - To ensure that performance appraisal / rewards are consistently applied and to create a more objective test that can be audited.
- Risk Sensitive Incentive Systems
  - To ensure that incentives are in place to encourage the (risk) culture that the board wish to see in the organisation.
  - We use the term *Incentive Systems* in its broadest sense to mean the *Reward System* and *Dis-incentive System* that an organisation uses.
  - We use the term *Reward System* in its broadest sense to mean the full range of rewards such as advancement and preferment,

	as well as monetary compensation. o We also use to the term *Dis-Incentive Systems* in its broadest sense to mean the full range of dis-incentive a firm uses, not just the disciplinary system. • Recruitment / Induction o To ensure that recruits are selected who will accept the corporate ethics and values. o To ensure that the corporate ethics and values are fully understood and learnt by the new hires. The IRM document Risk Culture: Resources for Professionals gives more guidance (Chapters 9 and 10) about implementing a sound risk culture. A successful organisation will have developed a culture that enables it to make a consistent profit otherwise it would not exist. The organisation should therefore have mechanisms for learning how to make a profit. Uncovering these learning mechanisms and harnessing them to learn about downside risk is an important conduit for embedding a (risk) culture. In conclusion, we encourage the FSB to ensure that due attention is paid to the non-financial risks as well at the financial risk, especially as these can be more relevant at other levels of the organisation and can cause or be catalysts for the financial risks. We have suggestions for the ways in which a sound (risk) culture can be embedded which include: • Accountability • Speaking-Up / Upward Communication • Clarity of Purpose • Clarity of Acceptable / Unacceptable Behaviour • Risk-Sensitive Incentive Systems • Recruitment / Induction

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