

Creating a resilient risk culture: Our perspective

The financial services industry is in the midst of radical transformation. Today's customers demand more options, creative solutions, greater flexibility and faster response. Survival, much less success, in this new world demands a banking organization with the intelligence, agility and speed to keep pace with today's customers and the technologies swirling around them.

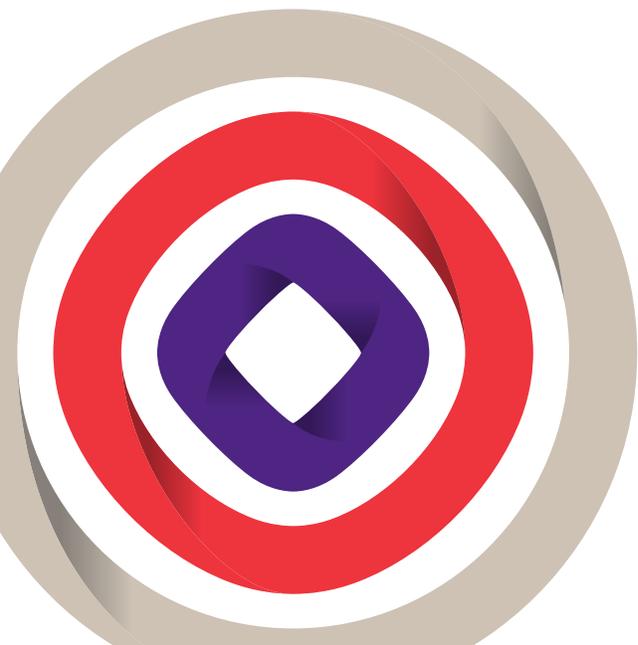
Risk can no longer be relegated to compliance and isolated risk management functions. In truth, the holistic embrace of risk management is more fundamental to the business of banking than to almost any other industry.

And that means it's a question of culture.

Culture permeates all business activities and shapes the conduct of everyone in an organization. How things really work at the firm, or what we really do when nobody is looking, has a major impact on the day-to-day decisions and behaviors of employees. There is a direct link between the culture of an organization and the conduct of its people. Culture is the glue that binds individuals to an institution.

Some will ask, “Can processes, controls, and governance be put into effect to replace the need for an effective risk culture?”

In our experience, the answer to that question is a resounding, “No!” Processes, controls and governance can go only so far. As recent industry scandals reveal all too painfully, the day-in, day-out actions of men and women throughout the organization matter deeply.





Risk culture in banking today

So it comes down to this: Only through cultural resiliency can banks withstand the pressures of evolving business environments, shaped by rapidly changing technologies and unconventional competitors.

Given the starring role of culture in the risk management function of the future, we focused a full section of our research survey, developed jointly with MIT's Golub Center for Finance and Policy, on the steps that banks are taking to sustain effective risk cultures.

Not surprisingly, we found that banks are aware of and taking steps towards building more risk-aware cultures.

Key findings:

Starting with across-the-board transparent accountability, large and small banks alike are planning specific, internal actions to strengthen their risk cultures.

- Chief risk officers (CROs) are gaining influence within institutions, which we believe indicates that banks are prioritizing risk management.
- A strong majority of respondents (75 percent) expect their institution's risk management activities will be performed more or much more by the first line of defense (lines of business).

But we wonder: Are banks doing enough to build effective risk cultures?

Building a resilient risk culture

In our work with a broad spectrum of midsize and larger banks, we've learned that developing risk-aware culture is not the result of an accident or a serendipitous event. Quite the contrary, culture is the product of a conscious institutional attitude that typically emerges from experience, tenure, and business maturity.

As the epitome of institutional culture around risk-taking activities, a bank's risk appetite statement should link coherently with business strategic intents and objectives. Furthermore, business incentives and balanced performance measurements play a critical role in maintaining and preserving the dominant culture of the institution.

Because circumstances and business conditions constantly change, associated behaviors must change as well. Therefore, frequent and consistent reinforcement mechanisms are critical to maintaining this risk foundation.

To be resilient, risk cultures must be responsive as well. In our experience, we've seen that a consistently assimilated and embraced risk culture is essential for surviving and negotiating critical episodes and business scenarios. In this regard, culture must be responsive to exogenous factors over time. For example, risk regulatory frameworks significantly bolster the importance of a solid risk management culture and the recent evolution towards heightened risk management practices. This complementary role of effective supervision in improving risk culture cannot be ignored.

Setting the tone

To be sure, tone at the top always matters. Especially with the speed of change in banking, leaders have a critical guiding role to play in reinforcing risk resiliency in times of innovation. Risk awareness must be baked into new business models and new technologies, just as innovation is leveraged to help manage risk itself.

Yet it is crucial to actively reinforce and reiterate the tone at the middle and at the bottom of the organization through appropriate and dynamically managed incentives. As noted above, our survey found that responsibility for risk management is moving steadily to the first line of defense. We see this as entirely appropriate; as lines of business seek growth with new products, services or capabilities, the risks they introduce must be factored into their development.

In this regard, with the concept of “conduct risk,” the United Kingdom is taking a lead in building risk culture into its regulatory framework. This notion of conduct risk integrates with enterprise risk—whether it is ensuring compliance to new conduct risk rules, managing conflicts of interest, preventing market abuse, or building robust audit procedures around new product development processes.

From our perspective, we see conduct risk as a concept whose time has come. While we do not advocate for explicit regulation as has been adopted in the UK, we do believe these are fundamental questions that every bank should consider carefully.

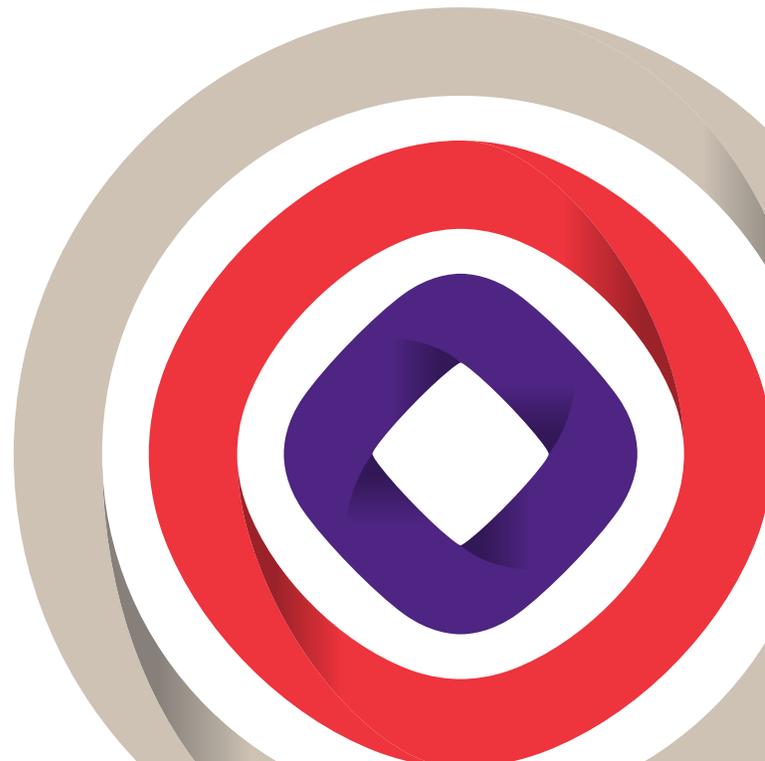
“Risk consciousness”: Making risk everyone’s business

Risk-conscious institutions are both resilient and driven to create value. To be risk conscious, their employees must elevate the consideration of risk management across every business process, from account origination to systems implementation and resource management.

For many institutions, achieving “risk consciousness”—making risk everyone’s business—represents a significant shift in mindset, policies, systems and processes and requires an ongoing, long-term commitment and investment. As technology at the intersection of humans and machines, including algorithms and artificial intelligence, continues to expand its role in bank decision-making its, effect on culture must be considered.

Culture is notoriously hard to measure. It’s not something you can plot on a line. But as we’ve seen in the banking industry, failures of culture can hit institutions with explosive impact.

We believe the best expression of risk culture is a well-articulated risk appetite framework. To be effective, this framework must cascade throughout all strategy and business planning, risk policies and procedures as well as performance, incentives and compensation decisions.



How we can help

Our Advisory Services professionals have significant expertise in risk solutions and industry experience, inclusive of Financial Services, Healthcare, Life Science, and Technology. We help clients define and execute their business strategy in alignment with their overall risk appetite to create business value. We deliver practical, innovative, and holistic risk management programs and solutions to address strategic, operational, financial reporting, regulatory compliance, digital, and cyber risks.

Across many industries, we're helping our clients transform from compliance-based to performance-driven risk management that creates value for their enterprises in seven areas.

1 Risk function transformation

We help clients implement heightened risk management (RM) functions and related processes to increase business value and functional efficiency, improving risk identification, culture, and control effectiveness; and optimizing three-line-of-defense operating models and upstreaming risk activities.

2 Data & risk analytics

We assist clients with implementing model risk management solutions: deploying risk analytics, algorithms, advanced forward-looking methodologies, and data science solutions for regulatory, business, and RM decision-making purposes.

3 Financial risk management

We support clients that are implementing sustainable RM solutions and stress-testing, improving capital, liquidity, market, and credit risks.

4 Operational risk management

We assist clients that are optimizing risk assessment and business processes performance through cohesive operational RM programs, including customer-centric and resilient frameworks covering non-financial risks such as digital, cybersecurity, and third-party/vendor risks.

5 Integrated risk infrastructure and technology

We support clients in the optimal deployment of governance, risk, and compliance solutions, as well as architectures, platforms and tools.

6 Regulatory compliance

We help clients to optimally satisfy changing rules and dynamic regulatory guidelines and to effectively respond to external regulators and supervisors observations and expectations.

7 Controls advisory, forensics and specialized assurance services

We deliver bespoke services for our clients, including leading internal audit sourcing solutions.

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