Risk culture, behaviours and story-telling.

A speech given at BAFTA following the UK showing of *Moremi*, a film based on a West African folk-tale, produced by Edutainment.

Isn't it exciting what comes out of Africa? It reminds me of a little book on risk[1] which I was reading a few weeks ago. It mentioned an anthropologist, Mary Douglas, who studied the Zande tribe in central Africa in the 1920's. She came up with the striking observation that risk managers were assuming the role of witchcraft, when they establish rules for dealing with danger. So let's hear it for the witch doctors of risk management. There's more that comes out of Africa than you might think.

But tonight is not about the magic of risk management but about story-telling. Here at BAFTA they of course celebrate story-telling as a way of entertaining us, but at their best those stories ask us to re-examine ourselves and our behaviours, to educate ourselves. We might even say 'That's edutainment'!

And story-telling is also at the heart of risk management – what are scenarios but stories? Which is why they're such powerful tools.

But story-telling is also one of the elements which bind us. Stories reflect our collective consciousness, our collective <u>culture</u>. A couple of weeks ago at the BAFTA film awards, 2 films in particular stood out for me when I was thinking about tonight - The Iron Lady and Tinker Tailor Soldier Spy. The drama of each film was about the stories of two, in some ways extraordinary, cultures. In the case of the Iron Lady, in fact, her mission was to change the very culture of the UK, the country of which she had become prime minister, as well as of the politicians who surrounded her. You will have your views of how far, or indeed whether, the iron lady succeeded. But the important point of both films was something about culture.

And it's a similar tale in financial services. Many studies of the financial crisis – and the targets since of regulators and politicians – have concentrated on things like inadequate capital, insufficient liquidity, poor lending strategies, as exemplified in particular by sub-prime lending and then its disintermediation through derivatives. In other words, the solutions have concentrated on the financial risks of credit risk, market risk, liquidity risk. They certainly help us to understand *how* we got to the mess we are in. But do they really say anything about the 'why'? Do they really tackle the root causes of the crisis?

It seems to me that the real cause of the crisis was a failure of risk management. Not so much that people tried risk management and it failed – though ther was something of that. No, the failure was to apply proper risk management at all. A failure to operate a good risk culture.

Risk management in many firms took a back seat. It got lumped with compliance – something firms had to do to keep the regulators happy. Indeed, you get the sense that discipline and good behaviour – the basic elements of any culture - were effectively outsourced to the regulator. It's OK so long as we can get away with it. <u>Not</u>, it's OK because we believe it's the right thing to do. Risk managers lacked authority. Whilst the party was going on around them, like Cinderella they were left behind, unloved and ignored, waiting forlornly for a Prince Charming who knew their value.

That fundamental failure was highlighted by the US Congress's Financial Inquiry Commission which reported early last year. Its key conclusions were that there had been 'dramatic failures of corporate governance and risk management at many significantly important financial institutions' and – and this is the important one - that there had been a 'systemic breakdown of accountability and ethics'. It all sounds to me like a cultural failure.

Use of that word ethics brings out an important lesson. Banks, and perhaps the wider financial sector, have got to bring their culture back in line with the culture and norms of the society in which they operate. Their failure to do that is what has caused the popular – and from politicians populist – antagonism towards them. Rather rich, in my view, coming from some of our MPs – but there we are.

Of course in some ways it could be said that bankers did reflect the norms of society. Bankers were greedy. Yes. But then so were investors, so were borrowing customers, so were politicians, who were delighted to have a mass of happy voters, mortgaged and borrowed up to the hilt and enjoying every minute of the good times which were rolling. It was a cultural thing.

Above all everybody lived in a fairy-tale world of a kind of collective hubris. You'll remember the ineffable Chuck Prince, CEO of Citigroup, certainly not a Prince Charming, who famously said in July 2007, just before the financial tsunami hit the shores, 'As long as the music's playing you got to get up and dance. And we're still dancing,'.

The good times would go on for ever, nobody would get hurt and we would live happily ever after. A beguiling story. And if anybody doubted the Hollywood (or BAFTA) ending, they kept very quiet,

That was the culture and for some countries and for millions of people now the results are very painful.

But the fact is that banks *were* irresponsible and incompetent and greedy. Pay was not aligned to risk – or to talent. Products may have been complex – but not so complex if you actually bothered to look at them and challenge how they worked. Credit risk was abdicated to credit rating agencies, which were themselves incompetent, and then relied on the First Amendment – it was only their opinion - to avoid blame.

Those of us who are old enough may wonder whether it all goes back to 1986 and Big Bang, when Meryl Streep, sorry, Margaret Thatcher, had been in power for 7 years. The City then was very much a closed community, bound by a common culture which was led from the front by the raising of the Governor's eyebrows. Incidentally, if the Governor called you in for tea, you went back to the office and sorted things out, but if you were invited to lunch, you didn't even bother going back to the office. You quietly left the City, never to return.

But anyway, a new breed arrived from Wall Street to challenge the old-school behaviours of Lombard Street and indeed of Main Street back home. The name of the game was competition and in <u>that</u> game you had to be more of a bare-knuckle street fighter. It was about the individual, not teamwork. A hugely different culture, almost a frontier culture, and, with no apologies to my American friends, I would say a culture which was fatally corrosive. But it swept all before it around the financial globe, which tells you something about human beings as much as anything. Perhaps there's a Gordon Gekko lurking in all of us.

Which just goes to show that culture is a slippery term. It's simply an expression of 'the way we do things round here', an expression of the attitudes, values, behaviours and actions of a particular group of people. Maybe there's no single idea of a 'good' risk culture. Well, maybe. But maybe there is.

For me it's a world where we know what we mean by excellent behaviours – and what we mean by unacceptable behaviour; where we have shared values which we all understand and follow.

Culture is the glue that binds societies - and companies. Why do most mergers fail to deliver what was expected of them? Generally, because everybody is busy looking for so-called synergies which may or may not materialise, but, importantly, because senior management rarely thinks about the two companies' cultures and develops a vision of what the merged company's culture will be. Another reason, incidentally, why co-heads should be banned.

As ever, it all starts at the top. If there's infighting at the top, that will very quickly be communicated down through the organisation. But assuming the Board sets the right tone and is clear about its values and what it means by excellent behaviours, it must then communicate that culture – by words <u>and</u> its actions – down through the firm.

If that happens, the tone at the top will be translated into the tune in the middle. That's where, if you listen carefully, you'll see if the risk culture is truly embedded in the firm.

It's done not with eyebrows, but with leaders, who make it clear what the culture is and who walk the talk.

It’s a world where there are clear roles and responsibilities (unlike, it seems, the UK Border Agency); where there is continuous and constructive challenge; where there is active learning from mistakes. As you probably know, it’s common in the airline industry for pilots and indeed others on the aircraft, not to be punished if they make a mistake or if something goes wrong – provided they report it first. Safety is paramount, so mistakes are logged and acted upon, including by changing training programmes. You may be horrified to learn that a transatlantic flight will typically generate over a hundred entries in the error log. Or you should be grateful. It is, after all, a practical example of a good risk culture.

But coming back to the airlines, wouldn’t it be great if people in other industries were encouraged to admit their mistakes, so that the firm’s performance continuously improves? It’s a culture thing and it can happen, if you really want it to.

Identifying and understanding the culture is one thing. But it then has to flow through into all aspects of employment. As with most things to do with risk, it’s all about people. So it amazes me how few HR Directors are not seen, or indeed see themselves, as one of the key risk managers – or perhaps I should say witch-doctors - in the firm.

When we select a new employee, who does the selection? The immediate boss? Yes – however bad they are at interviewing people. But anybody else? When it comes to senior appointments, is there a group of people who are used, who understand how the firm ticks, so that new recruits are more likely to fit in with the firm’s values and culture ?

And once selected, is performance assessment linked to good behaviours? Which of course brings me to pay. I hate that weasel word compensation, by the way. What are we being compensated for? Loss of liberty and the pursuit of happiness? Anyway pay. To what extent is it linked not just to profits (preferably sustainable profits) or sales, but to good behaviours? To what extent is inappropriate behaviour actually punished?

At BP they have 10 cardinal rules. If you break any of them, you get the sack. One of them is that you mustn't speak on the phone, even hands-free, whilst you're in your car. Last year, a senior manager had left the office at the end of the day and was sitting in his car in the car park, about to drive off, when his phone rang. Thinking it was to do with something he'd just sent off before leaving, he answered the call, was spotted by security - and was sacked. Harsh - but there's no point identifying inappropriate behaviour and spelling out the penalties and then doing nothing about it, even when, perhaps I should say especially when, it involves a senior manager.

But for me the golden key to a good risk culture – and I believe the message of *Moremi* – is that there must be open lines of communication up and down the firm. The financial crisis highlighted the number of CEOs - and politicians - just like our friend, the King in the film, who were protected from the bad news, or who ignored it when they were told.

And excellent risk culture is where, in a line from *Moremi* which I found particularly telling, 'the small voice has the loudest echo'. That means listening to the messages coming to you from everywhere in the firm. Story-telling – an essential part of any culture, risk or otherwise - is as much about listening as it is about speaking. So listen to the stories, listen to the tune in the middle, and you'll learn a lot.

Thank you.

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[1] Baruch Fischhoff & John Kadvany, *Risk: a very short introduction* (OUP, 2011)