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Cure for the common culture:
How to build a healthy risk culture

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Executive summary

"Are compliance programs put in place by risk managers or general counsels understood as a kind of background noise that should not drown out the voices urging employees to 'make their numbers,' or are they seen as reflecting the views and priorities of senior management?"

— Governor Daniel Tarullo, Board Member, Federal Reserve [4]

PwC's 2014 Global Banking Risk Culture Survey shows that nearly 40% of respondents do not think there is a complementary balance of power between the risk and business functions within their institutions. Do you have the right risk culture at your bank?

Banks have invested heavily in attempts to cultivate an internal culture that promotes ethical behaviors and deters risky ones.

Despite this, allegations of misconduct, regulatory challenges, and fines have persisted:

- 2011: A large bank disclosed that it had lost more than $2 billion due to unauthorized trading by one of its employees.[1]
- 2012: The five largest mortgage servicers in the United States agreed to a $25 billion settlement with state attorneys general and federal agencies to address mortgage loan servicing and foreclosure abuses.[2]
- 2013: Federal regulators reached a $9.3 billion settlement with 13 banks in the so-called robo-signing scandal related to mortgage foreclosures.[3]

Banks have invested significant resources into multiple programs to foster a healthy risk culture. Why are their efforts falling short? How can they inspire true behavioral change and cultural health?

1 Lindsay Fortado and Ben Moshinsky, "Trader charged in $2B loss; London authorities say worker at noted firm allegedly engaged in fraud dating back to 2008," September 17, 2011, www.factiva.com, accessed September 9, 2014.
2 Robert Bostrom, "Mortgage Servicing Update: Government, Servicers Reach $25 Billion Settlement," February 21, 2012, www.factiva.com, accessed September 9, 2014.
3 Alan J. Heavens, "Mortgage companies to pay $9.3 billion to settle complaints," March 1, 2013, www.factiva.com, accessed September 9, 2014.
4 Daniel Tarullo, "Good Compliance, Not Mere Compliance." Federal Reserve Bank of New York Conference, "Reforming Culture and Behavior in the Financial Services Industry" New York, October 20, 2014.

In our view, banks can encourage the risk culture they desire by focusing on the following six discipline areas:

Leadership: Adopt and exercise the perspective that leaders are role models who should understand, embrace, and exemplify the risk culture.

Governance and organization: Align the risk function and the business as strategic partners.

Communications: Promote and sustain the right risk culture with a clear communications strategy and transparency.

Talent management: Connect compensation and risk-adjusted performance.

Global operating norms: Establish consistent global operating norms.

Technology and infrastructure: Mine, manage, and interpret data.

We tapped insights from hundreds of global banking leaders who shared their thoughts and challenges on the risk culture question. In the following pages, we'll share what we found, provide some perspective on what this means for you, and share our recommendations for building a strong risk culture.

Point of view

The challenge of building a corporate culture that prioritizes risk management, ethical behavior, and smart decision-making continues to weigh on banks.

What do leaders of the largest banks in the world think about when they consider risk culture?

To find out, we tapped global banking executives to better understand their views on the severity of risk culture shortcomings, what's causing them, and how they can be addressed. PwC's 2014 Global Banking Risk Culture Survey draws on insights from 504 executives and managers across the United States, the United Kingdom, Hong Kong/Singapore, Brazil, and Australia.

Risk culture today: dreams and realities.

A large number of C-suite leaders have placed risk culture squarely on the agenda in response to the regulatory environment, recent highly-publicized missteps, and subsequent reputational and brand damage. Yet, we were alarmed to find that, on average, participants in PwC's Global Banking Risk Culture Survey graded themselves the equivalent of a C+ on their risk cultures. We would have expected at least an A-, given the effort and investment committed to date.

In analyzing survey responses, we see significant room for improvement in the following five areas:

1. **Inadequate authority and influence of the risk function.** There is widespread agreement that risk culture is a critical part of a successful financial institution, but banks have yet to create a true seat at the table for the risk function.
2. **Risk culture execution lags behind C-suite expectations.** Executives have made progress in setting the right "tone at the top," but management actions—in setting appropriate risk standards and promoting desired behaviors—aren't living up to these communications.
3. **No skin in the game.** Most banks have not done enough to change the underlying incentives and consequences that promote the right risk behaviors—and deter the wrong ones.
4. **Fragmented risk reporting.** The lack of comprehensive, readily available risk information continues to plague efforts to identify risks in real time.
5. **Inconsistent management of risks at a global level.** Few respondents saw continuity in how risk is managed geographically, with just over one-fifth saying that risk triggered in one location is analyzed consistently for global implications.

Turn risk culture into healthy realities around the world.

Banking leaders have an opportunity to shape a healthy risk culture that will help them proactively identify and mitigate risks, protect their brand, and unlock new growth options. Based on our analysis of survey results, we've identified five themes for banks to focus on in this effort:

1. Create a true seat at the table for the risk function.
2. Establish a walk-the-talk risk culture—from top to bottom.
3. Make change stick through better incentives and consequences.
4. Create more integrated, real-time reporting.
5. Develop a consistent global approach to risk management across regions.

Theme #1: Create a true seat at the table for the risk function.

Only **16%** of those surveyed strongly agree that risk management has the power to override decisions made by the business functions.

Risk considerations remain isolated from the business.

Our survey indicates an overwhelming recognition by respondents that risk culture is a critical part of a successful, competitive financial institution. More than 70% of survey respondents recognize risk assessment as integral to key business decisions in their organization.

But when it comes to delivering the risk culture, things don't always work out as planned:

- Nearly 42% of those surveyed said they do not agree that risk analysis for products and services is adequate.
- Only 66% of respondents agree or strongly agree that there is a complementary balance of power between the risk and business functions within their banks.

These results confirm what we've seen at many banks in that the risk function's involvement often comes too late or has been relegated to a check-the-box exercise.

Build a better balance of power.

Leading institutions are elevating the standing, credibility, and authority of the risk management function to protect the business from unacceptable levels of risk. They are taking these practical steps:

- **Changing the risk-business partnership dynamic.**
  Leading banks are working to change how the business sees the risk function, shifting it away from a policing role toward a risk advisory role. While it's hard to change these long-held beliefs, leaders are making headway by focusing on relationship skills and developing stronger knowledge of business operations on their risk teams.
- **Embedding risk into business decisions.**
  Executives and regulators are asking their business units to take a more active role as the first line of defense against risk. This involves clarifying risk roles and responsibilities, identifying risk triggers, and seeking risk counsel as part of key business decisions—not as an afterthought.
- **Reviewing reporting relationships**.
  The OCC's risk governance framework, finalized in September 2014, seeks to elevate the stature of CROs (or the multiple Chief Risk Executives that fill the role of the CRO at some banks). Leaders are taking a look at where Risk sits on the org chart, and creating direct lines of communication for the CRO to the CEO and board.[1]

1 OCC, *OCC Finalizes Its Heightened Standards for Large Financial Institutions,* September 2, 2014, www.occ.gov, accessed October 6, 2014.

Theme #2: Establish a walk-the-talk risk culture—from top to bottom.

30% of respondents do not agree that management actions consistently align with their communications regarding risk management.

Executives have made progress in setting the right "tone at the top," but respondents say that management actions aren't living up to these communications.

Nearly 90% of survey participants agree or strongly agree that leadership promotes "core values" over growing the bottom line. However, 30% of respondents do not agree that management actions consistently align with their communications regarding risk management. In our view, this likely reflects a disconnect between the tone at the top and how middle management executes on risk policies.

Survey results confirm what we've seen in our work with clients: despite investments in risk programs, many participants are still unsure about their banks' commitment to high-performing risk culture. They cite room for improvement in risk standards, communication, training, and recruiting:

- Over one-third of respondents did not think that risk awareness and education were sufficiently promoted across the organization.
- Less than one-third strongly agreed that accountability for risk management responsibilities was clearly defined.
- More than one out of every five participants did not feel that their organizations encouraged them to escalate business risks to management.
- Only 28% of survey participants strongly agreed that the organization recruits individuals with the necessary skills required to meet the organization's risk goals.

How to "walk the talk."

Leading financial institutions see risk culture as a multidimensional issue that needs to be supported by a combination of people skills, policies, and tools. We see leading banks:

- Developing clear protocols for what good risk management looks like.
- Opening channels for escalating risk issues.
- Underscoring a zero-tolerance policy for retaliation.
- Finding new and better ways to attract talent with the right risk mentality.
- Building risk-savvy approaches into the institutions' training policies and development programs. For example, some banks are requiring employees to participate in risk-related projects as part of their annual goals.

These efforts are paving the way for stronger, more sustainable risk cultures going forward.

Theme #3: Make change stick through better incentives and consequences.

3/4 of respondents disclosed that they were more motivated by financial rewards than less tangible rewards.

A surprising number of respondents don't have a direct stake in achieving risk goals.

When it comes to forming and enforcing a risk-aware culture, banks don't always put their money where their mouth is. And that can have consequences:

- Less than 40% of respondents are required to fulfill risk-related objectives as part of their annual goals, and less than 30% are evaluated for compliance with risk procedures as part of their performance reviews.
- One out of every four respondents admitted that they do not have a full understanding of the personal consequences for a compliance violation. Even more surprising, fewer than one in five respondents strongly agreed that compliance violations were consistently addressed in their organizations.
- Three-quarters of respondents disclosed that they were more motivated by financial compensation than other, less tangible rewards. This could be a red flag, since compensation that is closely linked with financial performance may encourage individuals to make reckless decisions to achieve short-term financial gains.

Good risk management is good for business.

Regulators are pushing banks to change their incentive structures, including compensation, development opportunities, and recognition. Leaders have started to take the following steps:

- **Dealing with compliance violations quickly and consistently.**
  By holding themselves and employees accountable for demonstrating the right behaviors, bank executives send a clear message about the importance of risk management and compliance.
- **Aligning incentives with desired risk behaviors.**
  By integrating risk metrics into how employees are compensated, assessed, and developed, leaders are demonstrating their commitment to promoting "good" risk behaviors over short-term profits.
- **Maintaining ongoing communication.**
  Leaders are communicating frequently with regulators, shareholders, recruiting candidates, and employees to reiterate their commitment to risk culture and the behavioral expectations that come with it.

Theme #4: Create more integrated, real-time reporting.

1/3 of respondents did not have access to readily available reports and dashboards to clearly identify risk in "real time."

Current risk reporting tools aren't fulfilling today's needs.

While 80% of survey respondents agree or strongly agree that adequate controls are in place to identify potential risk violations, institutions continue to struggle in their efforts to identify emerging risks across business units and geographical regions. One of the major barriers cited is the lack of readily available reports and dashboards:

- Less than 5% of survey respondents strongly agree that their organization has all the requisite tools available to completely analyze risk and make well-informed decisions.
- Only 16% of respondents strongly agreed that there were established processes to proactively identify early warning signals or emerging risks.

Most risk systems function in silos that formed as business units responded to one-off risk requirements. What's more, today's systems often lack the ability to access highly granular levels of data—a demand that could not have been foreseen when these systems were being developed.

The result? Executives are unable to get the single view of risk that they need to see how risks taken across the organization are correlated—and their cumulative impact on the organizational risk profile.

Get the right information at the right time to make the right decisions.

Forward-thinking financial institutions are investing in more consolidated, real-time risk reporting. Some have invested in internal tools, while others have taken advantage of the increasingly sophisticated risk technology offered by third parties. In either case, their goals are the same:

- **Developing an enterprise-wide view of data**—to overcome fragmented technology, inadequate risk reporting, and long-standing silos.
- **Building greater access to information**—to improve management's ability to proactively identify, escalate, and track potential risks. For example, instant queries and customizable reports have helped management keep pace with business changes.
- **Improving communication channels**—to help risk information get to the right people, when and where it's needed.

Theme #5: Develop a consistent global approach to risk management across regions.

Only 1/5 of respondents strongly agree that risks triggered in one geography are consistently analyzed for global risk implications.

Alarmingly few survey participants reported continuity in the way risk is managed geographically.

Just over one-fifth of survey respondents said that risk triggered in one location is analyzed consistently for global implications. The potential impact is disturbing, since it only takes one rogue trader in a distant region to wreak havoc across an established global bank.

In fact, participants scored their ability to manage risks on a global level lower than their performance in all other risk management categories. Respondents from Australia and Brazil, in particular, expressed doubts about their entity's ability to respond effectively to global risks.

Australian respondents had the lowest results of any geography surveyed. For example, over 55% of Australian respondents noted that products and services are not sufficiently analyzed for potential risks—13 percentage points lower than the global average. In addition, 45% of these respondents noted that risk awareness and education are not sufficiently promoted across the organization, compared with 34% globally.

Australian respondents also noted that technology is not where it should be, with nearly 40% noting that their organization does not have the tools available to completely analyze risk and make well-informed decisions, compared with 29% overall.

Brazilian respondents also noted similar shortcomings in these risk categories. For example, over a third of Brazilian respondents noted that the risk management function does not have the power to override business decisions—11 percentage points behind the US. Brazil also noted shortcomings in technology, with over 40% not having access to "real-time" reports and dashboards, compared with 30% globally.

Hong Kong/Singapore respondents scored the lowest in the categories of Leadership and Governance & organization. In particular, nearly half of respondents do not agree that management's actions match their communications regarding risk, compared with 30% globally.

Take risk management to global heights.

These examples demonstrate the shortcomings still present in certain geographies. Global banks need to remember that it's not enough to create a global policy and mandate its adoption. Banks also need to gain perspective about the local markets they do business in, and adapt their risk initiatives to those markets.

In our view, banks can encourage the risk culture they want by focusing on six areas of discipline.

Leading banks know that risk culture is a complicated thing that needs to be supported by a combination of people skills, policies, protocols, and tools. As shown in Figure 1, we encourage banks to focus on six areas to build the risk culture they want.

Figure 1: The six key areas of risk culture

It's hard to rally an organization to think about changing the risk culture—after all, the mark of a strong risk culture is a company that* doesn't *make headlines.

"Culture relates to the implicit norms that guide behavior in the absence of regulations or compliance rules—and sometimes despite those explicit restraints. Culture exists within every firm whether it is recognized or ignored, whether it is nurtured or neglected, and whether it is embraced or disavowed....It is how people react not only to black and white, but to all of the shades of grey."

—William Dudley, CEO, Federal Reserve Bank of New York [1]

Failure to build an effective risk culture can have far-reaching implications that stifle business growth.

Undesirable behaviors may recur:

- Leaders and staff don't operate according to a consistent, well-defined code of conduct.
- Business units forge ahead with risky initiatives, despite objections from risk leaders.
- Risks are not escalated and mitigated on a timely basis.
- Unacceptable behavior is not dealt with quickly and consistently, leading to mixed messages about the priority of ethics and compliance.
- Employees are less engaged and demonstrate a lack of professionalism and loyalty to the firm.

The potential consequences for banks can be severe and long-lasting. They may include:

- Regulatory fines and increased scrutiny by the public, customers, and vendors.
- Adverse impact on external brand and reputation, leading to potential loss of business and diminished access to capital.
- Loss of talent as experienced employees migrate to other banks with stronger risk cultures or alternative business models.

1 William Dudley, "Enhancing Financial Stability by Improving Culture in the Financial Services Industry." Federal Reserve Bank of New York Conference, "Reforming Culture and Behavior in the Financial Services Industry" New York, October 20, 2014.

It's one thing to envision the risk culture you want. It's quite another to develop and maintain it. Leading banks share these traits:

- **They balance people and technical skills.** Cultivating the right risk culture calls for soft skills, such as leading by example and building relationships. But it's also grounded in technical things such as credit risk policies, escalation protocols, and risk dashboards. The extent to which banks recognize and balance these skills can play a pivotal role in realizing risk culture goals.
- **They tailor risk initiatives to local markets**. It's not enough to create a global policy, mandate its adoption, and assume that all will end well. Banks also need to gain perspective about the local markets they do business in—everything from business models and practices to cultural norms and people.
- **They proactively engage with regulators.** Better communication and collaboration with industry forums and regulators can create a more open dialogue about what works, what doesn't, and what challenges to expect.
- **They take a long view** when building their risk cultures, and refuse to be distracted by the "issue of the day." This means putting the right infrastructure in place to develop a risk culture vision, and the plan to achieve it.

Competitive intelligence

Our observations of industry practices.

We've observed a number of leading practices that have helped banks build an effective risk culture.

Area of discipline	Leading practices
Leadership	• Set the tone for the organization's risk culture by "walking the walk." • Consistently identify and escalate business risks and encourage others to do the same.
Governance and organization	• Consider organizational and communication changes that will support stronger partnerships between the risk function and business units. • Promote collaboration between Risk and the business units by defining how Risk will be involved in key business decisions up-front. • Define and assign key risk-related business decisions to those capable of recognizing risk and managing it.
Communications	• Share risk awareness and education materials across functions, businesses, and geographies. • Put mechanisms in place to encourage escalation, rapid response, investigation, and attention by all employees.
Talent management	• Use rewards and consequences to demonstrate that risk management is everyone's responsibility. • Maintain a rigorous recruiting process that embeds risk culture characteristics into hiring requirements.
Global operating norms	• Manage global geographic risk by assessing how events in one region may trigger risks in another. • Customize risk management practices based on local business practices and operating norms, where possible.
Technology and infrastructure	• Invest in technology upgrades to enable integrated decision making. • Establish processes to mine, manage, and interpret data across product, customer, finance, and the workforce. • Use technology infrastructure and risk reporting to attain a 360-degree portfolio view of enterprise risk.

In our industry experience, few institutions execute leading practices across all six areas. We'll show what we've seen in the field, starting with leadership:

Area of focus	Financial institution A	Financial institution B	Financial institution C
Leadership	An executive was appointed to lead the global implementation of a multi-year risk reengineering program. The goal was to achieve the following outcomes: – Establish consistent leadership behaviors across a broad geographic footprint. – Encourage staff to proactively identify and escalate risks. – Develop a culture where individuals felt comfortable challenging the well-established "command and control" leadership model.	The institution faced multiple challenges aligning the risk cultures of multiple regional banks it had acquired: – Supporting incumbent management through the risk culture design during an uncertain period. – Assessing the gaps between legacy, current, and target state culture. – Addressing inconsistent behavioral expectations and norms in the various legacy environments arising from multiple past acquisitions.	A large global bank wanted to conduct an assessment to confirm that the values outlined in their ethics framework were embedded in the day-to-day operations of the organization. Activities included: – Appointing a senior leader to champion and drive usage of organization's values and risk management culture. – Conducting interviews and focus groups with employees at all levels to identify and address gaps in risk management behaviors. – Creating metrics and monitoring process to identify progress in establishing appropriate risk management behaviors.

Leading On par Lagging

Our observations: governance and organization.

Area of focus	Financial institution A	Financial institution B	Financial institution C
Governance and organization—Decision rights	The institution simplified its global governance model by: – Rationalizing a large number of committees to reduce redundancy in roles and clarify accountability. – Enabling consistent decision making across governance committees by leveraging common decision-support tools such as business impact assessments. – Implementing decision processes that required an impact assessment (across functions, lines of business, and geographies) prior to approval.	The bank rapidly deployed a new governance model to accelerate cultural integration of multiple acquired banks: – Developed decision rights policy to identify executives and committees responsible for key business decisions. – Maintained robust communication channels with all levels of management to provide transparency into decision-making process. – Analyzed major business decisions for regulatory, legal, and compliance factors.	The firm deployed a non-traditional form of governance and decision making: – Management preferred to create and retire committees rather than rely on standing committees. This resulted in varying standards in risk decisions. – Rigorous analysis and debate occurred in committees; however, some decisions were driven by politics. – Decision-making cycle time was longer than comparable banks. However, the bank benefited from minimal rework, stakeholder buy-in, and rigorous analysis.
Governance and organization—Collaboration	The traditional organization model—with a centralized risk function and business risk managers aligned with business units, functions, and regions—remains. This has resulted in the following organizational challenges: – Risk management was seen as a control function, not a business partner. – Risk function independently initiated risk reviews and risk mitigation programs without input from the business.	A traditional risk organization model was deployed, with increased collaboration with other corporate functions: – Risk managers were organizationally isolated from the lines of business, and did not partner with them. – Legal, compliance, and audit departments did not fully coordinate or partner with the risk function to complete broad-based risk reviews.	The firm operated in a self-organizing manner to manage and mitigate risks: – Consensus-driven management style enabled a high degree of collaboration across functions. – Rotation of leadership and staff through multiple functions increased organizational collaboration. – Risk identification, analysis, and mitigation planning were embedded in management decision making.

Leading On par Lagging

Our observations: communications and talent management.

Area of focus	Financial institution A	Financial institution B	Financial institution C
Communications	A minimalist approach was taken to developing the communications strategy: – Global risk management center of excellence was established to share leading practices, but lacked the authority to implement its recommendations. – A basic infrastructure exists for employees to anonymously escalate risk issues, but information is not communicated in a timely manner. – Global risk-related communications are applied inconsistently across the organization.	A simplified business model enabled this institution to more effectively manage risk through broad-based communications: – Key messages about the risk management framework, tolerances, and policies are cascaded. – Employees have access to a robust framework with multiple channels to anonymously alert management to risk issues. – Risk awareness campaigns and communications are widespread.	Risk communications are fully integrated with daily operations: – The risk issues log and mitigation plans are available to relevant staff, providing a high degree of transparency. – Major risk events trigger activation of a formal communication plan with employees, customers, shareholders, and regulators, as appropriate. – Robust risk analysis and communication support informed decision-making. – Risk communications are developed using a collaborative approach.
Talent management	The bank's recruiting and performance evaluation processes included only limited risk behavior. As a result: – Risk functions attempted to assess business unit processes without a comprehensive understanding of the business. – High turnover of risk management professionals led to loss of institutional knowledge. – Recruiting and hiring processes lacked mechanisms (for example, case studies, questionnaires) to assess employees' risk behaviors.	The institution increased focus on developing talent with robust risk awareness and knowledge: – Developed a competency model that included technical skills required to identify and prioritize risk. – Risk and compliance functions were tasked to think more strategically about risk, instead of merely assessing and policing adherence to risk policies and procedures.	Management focused on risk-appropriate behaviors when evaluating and rewarding talent: – Used simulations to increase awareness around potential risk situations and acceptable tolerance levels. – Rotated managers between business and risk functions to develop their behaviors. – Increased rigor in background checks for recruits to screen for risk-appropriate behaviors. – Embedded anti-money laundering operations into training to build proficiency across the organization.

Leading On par Lagging

Our observations: consistent global operating norms and technology and infrastructure.

Area of focus	Financial institution A	Financial institution B	Financial institution C
Consistent global operating norms	The bank focused on maintaining consistency in their global risk policy when managing growth in a foreign market: – Standardized risk controls to support Dodd-Frank, anti-money laundering, and internal audit regulation. – Increased oversight from the Board on risk issues that spanned multiple countries or territories. – Promoted long-term interests across the organization with risk-focused incentives.	The decisions of one region's risk decisions affected the institution's reputation on a global scale: – Compliance violations in one region caused 'finger pointing' by other regional offices, making it difficult to implement a centralized risk management function. – Global policies were interpreted locally in ways that were inconsistent with centralized company policy.	A centralized compliance and risk management function drove the risk management policies in a top-down manner across regions for consistency: – Centralized risk function monitored adherence to risk policies factoring in local country or territory risk tolerances. – Risk metrics were shared across regions. – Compliance staff were deployed on international rotations to develop global view of risk management and assess compliance with global risk policies.
Technology and infrastructure	• Compliance systems supported real-time analysis (for example, social media) and efficient reporting. • The bank was developing a single technology platform through a multi-year effort. • Infrequent focus on technology security left the firm open to risk from new threats.	• The organization lacked a common technology platform, resulting in limited integration of compliance reporting. • Risk scoring was not integrated, leading to inconsistent classification of the same client across different locations. • Reliance on manual processes and paper-based audit trails led to inefficient handling of information, lack of comparability across business units, and increased regulatory risk.	IT platforms and infrastructures were evaluated to standardize leading practices: – In-house platform enabled developers and employees to access data with a robust business process monitoring system. – Automated tools for training and analytics were frequently used. – Management could customize reports to keep pace with changes in the business. – Security restrictions were applied across applications to limit risk exposure.

Leading On par Lagging

A framework for response

Our recommended approach to the issue.

Our approach identifies the six key areas of discipline needed to create and sustain a healthy risk culture.

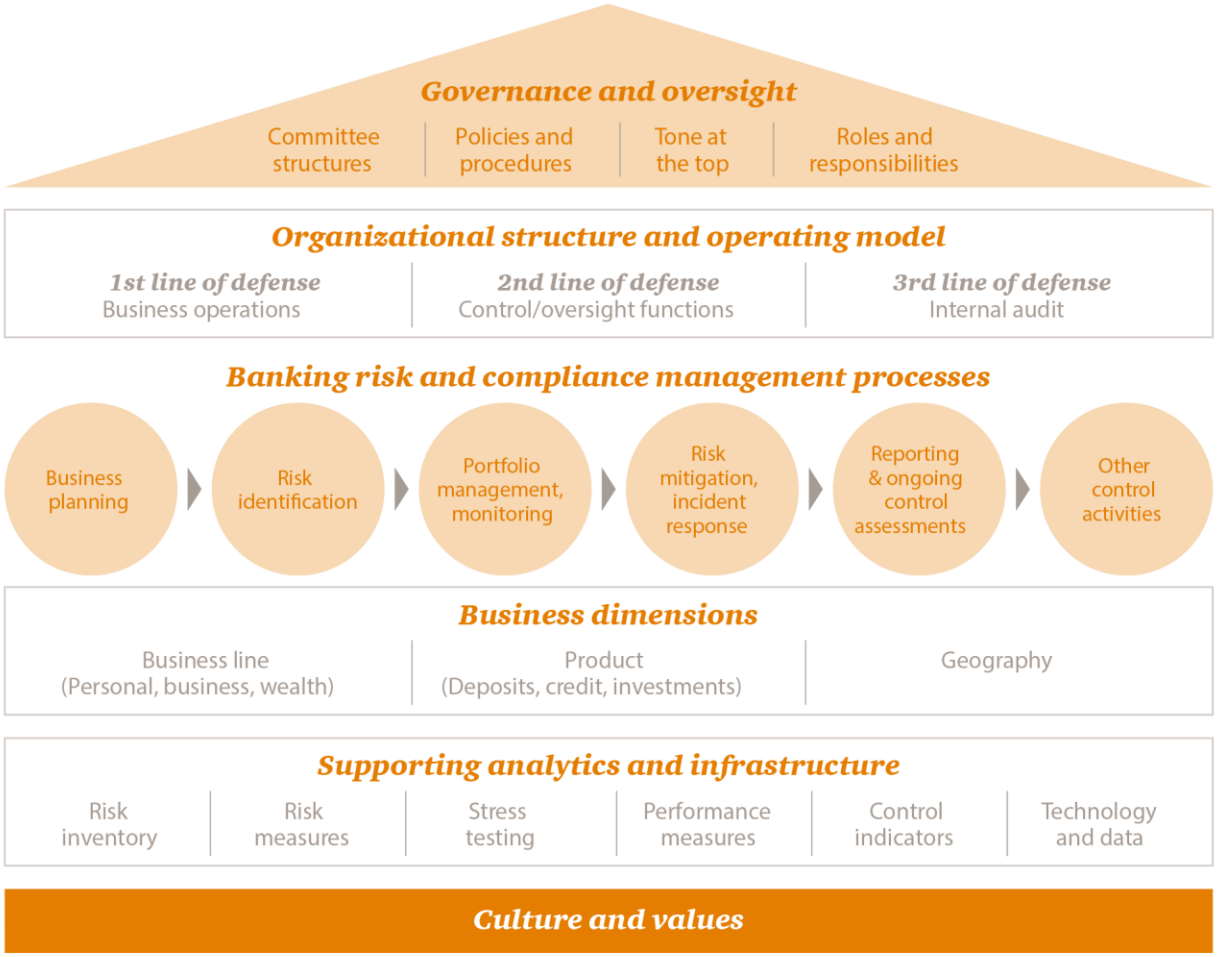
To build an effective risk management culture, you need to have a multidimensional approach that addresses soft skills, policies, and tools. The culture should be supported by a system of values and incentives, including tone at the top, talent, and compensation.

Maintaining focus on these six key areas of risk culture is critical to creating and sustaining a healthy culture:

The risk culture framework does not stand alone. It should be embedded within your approach for managing risk and compliance across the organization.

PwC's Governance, Risk, and Compliance framework includes an organization's culture and values as the foundation of effective risk management. The most successful banks are able to see how risk culture fits in with existing risk management structures. They understand which behaviors should be changed, and which should stay.

Figure 2: How the risk culture framework links with the Governance, Risk, and Compliance framework.



Leadership: Hold leaders accountable for their actions.

As role models, executives should demonstrate the right behavior on a daily basis and hold themselves accountable for monitoring and enforcement.

Their attitudes and actions about risk shape the risk environment and culture. Their behavior must exemplify the ethical behavior they want to permeate the corporate culture.

An organization sends an important message about the priority of ethics and compliance based on:

How unacceptable behavior is dealt with

Are compliance violations dealt with quickly and consistently?

The place of risk functions on an organizational chart

Does the CRO (or other key risk executives) report directly to the CEO and Board?

How risk is integrated into the decision-making process

How do I make sure that risk personnel are adequately involved in strategic business decisions?

Investment in tools and processes for employees to manage risk

Do my employees have the right information and tools to make informed risk decisions?

How early warning signals are addressed

Am I creating an environment that facilitates adherence to risk policies?

The frequency, content, and tone of leadership communications regarding risk

Are my actions aligned with the messages I communicate regarding risk?

Governance and organization: Define and manage critical decisions affecting risk at an appropriate level of governance.

Decision rights are a fundamental element of effective governance. Have you developed a decision rights structure that assigns decision-making permissions to the appropriate levels of accountability?

The OCC's 2014 risk governance framework requires that you clearly define the boundaries of the three lines of defense.[1] You should assign decision-making responsibility within those three lines to individuals that is consistent with the bank's risk appetite, strategic planning, and concentration and limit setting.

We've identified three key steps to help banks define their decision rights structure.

Key steps	Activities	Examples
Create inventory	• Identify and document decisions that impact the organization's risk exposure. • Assess the likelihood and impact of risks. The impact of a decision should be considered holistically, including implications for employees, risk, financial, and brand. • Monitor the risk inventory for potential changes. • Periodically assess existing products and businesses and evaluate how they impact the organization's current risk profile (for example, based on changes to process, standards, exposure, and the like).	• New product launch that carries capital risk • Change in compensation framework
Assign accountability	• Determine which individuals or committees should be involved in reviewing and approving risk decisions. • Assign responsibility and accountability to the right organizational levels, considering who is in the first, second, and third lines of defense. • Provide personnel responsible for risk decisions the information and make sure they have the capabilities needed to understand how decisions will affect organizational risk.	• Board of directors • Business unit level management • Regional committee
Communicate decisions	• Once a decision has been made, document and communicate as soon as possible to all business units and employees likely to be impacted.	• Targeted communications, such as region-specific • Broad-based communications, such as policy changes

1 Office of the Comptroller of the Currency, "OCC Finalizes Its Heightened Standards for Large Financial Institutions," September 2, 2014, www.occ.gov, accessed October 16, 2014.

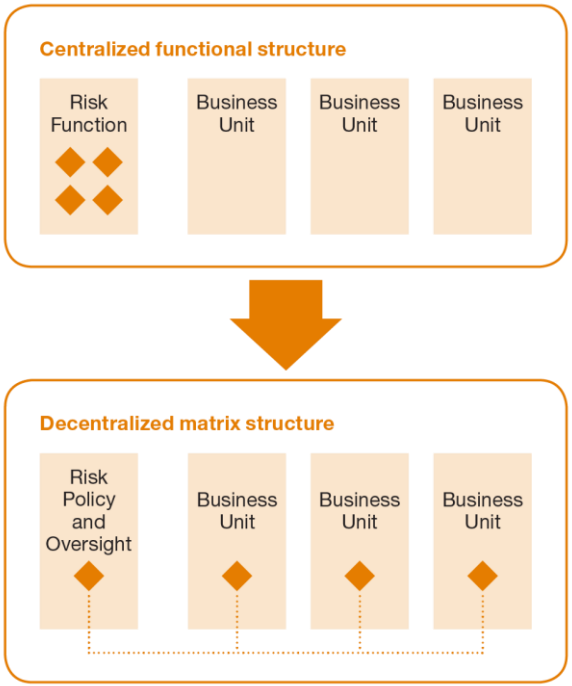
Governance and organization: To foster a culture of collaboration, the risk function needs to partner more closely with the business.

There is no one-size-fits-all method for increasing collaboration between the business units and the risk function. But collaboration can be encouraged through organizational changes, process updates, or investments in technology.

Some organizations have increased collaboration by changing the organizational structure and moving risk personnel into the business units to create a decentralized structure; in others, this objective is achieved by having the chief risk officer report directly to the CEO. (Refer to Figure 3 for illustrative example.)

Other organizations have modified key processes (such as those used for product development or merger/acquisitions) to require consultation from the risk function before processes can move forward. Removing technology silos, such as developing more unified systems to enable consolidated risk reporting, has also helped to increase risk consideration in business units.

Figure 3: Example of organizational structure supporting collaboration between risk and business units.



Key considerations:

- Are the roles for the first, second, and third lines of defense clearly delineated and defined?
- Does the risk management function have enough power to override decisions from the front office as a check and balance?
- Is the balance that exists between the business and risk functions healthy?
- Is the risk function viewed as an internal police force or a business advisor?
- To what degree are risk personnel involved in business planning efforts?
- How do the organization's career development policies and structure support the movement of risk personnel to the business?

Communications: Provide supportive channels for communicating and responding to risk issues.

Successful risk cultures use a formal approach to develop upstream and downstream channels that promote open and honest communication between employees and management. Companies with strong risk cultures have a strategy for effectively conveying leadership messages to employees.

We suggest that banks use a four-step approach to design and implement their communication strategies.

Conduct stakeholder assessment

- Identify and assess stakeholder requirements.
- Review the effectiveness of current communications and reporting mechanisms.
- Designate a core communication team and the reporting governance structure.
- Create stakeholder management tracking tools.
- Build stakeholder awareness and commitment.

Design communications strategy

- Develop a high-level communications and reporting strategy.
- Develop a detailed communications plan.
- Develop key messages and an initial communication package.
- Create safe channels for communication (for example, anonymous hotline, email, website, and the like).
- Develop a whistleblower policy to formalize non-retaliation standards.
- Define success metrics.

Enable rapid escalation of threats

- Develop and implement escalation and response protocols.
- Establish a reporting process.
- Execute communication and reporting activities.
- Monitor and update the communicates and reporting plan.
- Go live with website(s), hot line, and email lists.
- Deliver key messaging from senior management.

Institute continuous feedback

- Evaluate and refine the stakeholder engagement plan, as necessary.
- Measure effectiveness of leadership actions and ownership.
- Assess and measure success metrics.

Talent: Build risk awareness into hiring, onboarding, and training processes.

Banks should hire employees who can demonstrate a combination of traits: risk management expertise, adherence to a set of common values, operational experience, and soft skills.

Historically, risk personnel have had limited operational experience, hindering their ability to challenge business decisions. Leaders are finding ways to help employees develop business acumen and build relationships, such as implementing rotational programs or looking for nontraditional sources of talent to bring in operations experience.

We recommend that banks adopt the following steps to integrate risk awareness into the talent management process.

Key steps	Activities	Examples
Integrate risk management into the hiring and onboarding process.	• Assess employee and organizational awareness of and sensitivity to risk. Identify knowledge gaps in achieving the organization's risk awareness goals. • Recruit individuals with the skills necessary to meet the organization's risk goals, including the ability to effectively communicate and escalate risks. • Design new employee orientation programs to address the organization's expectations with regard to employee accountability for identifying and communicating risks.	• An asset management firm determines that it requires more employees with strong quantitative analysis backgrounds to support research and risk modeling functions. • A hedge fund chooses to hire individuals who demonstrate an ability to clearly communicate how they manage risk in the investment strategy. • A bank introduces new communications channels for disseminating risks (such as a whistleblower program).
Reinforce risk management through ongoing employee training.	• Implement an ongoing risk management training program for all employees.	• Circulate periodic newsletters to highlight new policies/processes and remind employees of their personal responsibilities. • Require employees to complete annual training. • Support tools such as anonymous employee hotlines.
Integrate risk management into the career development process.	• Make risk management one of the capabilities against which employees are measured as part of the annual review and promotion process. • Make certain that there is a robust career development path for individuals in risk roles.	• Employees fulfill risk-related objectives or metrics as part of their annual goals (for example, participation in risk-related projects, performing risk reporting and analysis). • Risk management personnel have equal opportunity for career development and movement within the company.

Talent: Align incentives and consequences with desired behaviors.

What gets measured gets done.

By aligning employee incentives and consequences with desired risk behaviors, banks can encourage employees to take a well-balanced view about risk taking. Performance management can therefore support the desired risk culture when incentives and consequences are shaped by clearly established behavioral expectations.

Figure 4: Desired risk behaviors are shaped by incentives and consequences.

Incentives

Employee

- Compensation structure
- Career development opportunities
- Recognition

Enterprise-wide

- Enhancement of global brand reputation
- Long-term profitability and shareholder value
- Decreased and managed risk exposure

Desired risk behaviors

- Compliance with risk policies
- Integration of risk in decision making
- Timely escalation and reporting of risk issues
- Communication of risk issues

Consequences

Employee

- Violations directly impact promotion or annual review results
- Financial penalties
- Termination, suspension, or re-assignment

Enterprise-wide

- Bankruptcy or termination of business
- Government bailout required for survival
- Damaged reputation

Consistent global operating norms: Centralize and standardize key elements of risk management on a global basis.

Consistent norms across borders give employees congruent insight into the organization's risk parameters, processes, and guidelines.

The corporate culture should supersede the regional culture with respect to risk adherence. Organizations need to understand the differences between the corporate culture and local office cultures so that policies and procedures can align local practices with corporate directives and values.

We suggest that banks centralize and standardize key elements of risk management on a global basis in the following areas.

Areas	Examples
Organizational structure	Risk personnel who are positioned in each country or territory are accountable for managing local risk issues. Regional risk personnel report to a global Chief Risk Officer.
Decision rights	Authority for approving decisions that create risk for the organization (for example, introduction of new products) must be approved by a global committee.
Policies and procedures	Risk policies and procedures are standardized globally.
Compliance and monitoring	Compliance programs for ensuring adherence to risk policies are consistently applied on a global basis. Expectations for business unit monitoring of risks have been clearly defined.
Issues management and remediation	Protocols for identification, escalation, and reporting of risk issues are globally defined and implemented. To help ensure proper reporting and remediation, critical risk issues may be managed by a global risk committee.
Communications and training	While risk communications and training may be tailored to individual regions to address local concerns, they adhere to global policies and procedures.

Technology and infrastructure: Improve information sharing, collaboration, and decision-making.

Technology should help promote and support the risk culture by driving effective information sharing and improve collaboration enterprise-wide.

Specifically, technology should:

- Enable informed decision making by the right people at the right time by providing the appropriate information in the appropriate form.
- Provide a comprehensive portfolio view of risk across the organization.
- Allow for employees to anonymously escalate risk issues.
- Develop and maintain a consistent environment for delivering training, assessing understanding, and recording certification for onboarding and recurring mandatory ethics, compliance, and risk training.

Appendix

Select qualifications.

Appendix—Select qualifications

Project and client	Issues	Approach	Benefits
Risk culture design and implementation—Global investment bank	The bank experienced major financial, regulatory, and reputational impact as a result of a significant trading incident. The event prompted the bank to pursue extensive improvements in the risk culture across its front, middle, and back offices.	PwC collaborated with the program sponsor, project team, and business leaders to design and implement a global behavioral change program. Specifically, PwC: • Worked with global leaders to help define target behaviors for all employees. • Facilitated stakeholder working sessions across numerous functions and regions to communicate and embed target behaviors. • Helped redefine the performance management framework to promote ethical behaviors and discourage those outside the bank's risk appetite. • Helped develop an implementation roadmap and success metrics.	The project helped the bank rebuild trust with internal and external stakeholders. This was achieved through: • A standardized set of target behaviors and metrics, established on a global basis. • Targeted communications rolled out to employees, customers, regulators, and shareholders. • Improved hiring practices, learning programs, and performance management processes consistent with target behaviors.
Risk management culture diagnostic—US regional bank	The bank was the subject of a number of regulatory, internal audit, and compliance reviews, which identified issues in quality, controls, and risk management. The reviews indicated that the bank needed to reshape its risk management culture.	PwC worked with management to conduct a risk review focused on the mortgage business unit. The work included the following components: • Conducted more than 50 executive and management interviews to identify cultural "pain points". • Helped define a common technical and behavioral competency model, and helped analyzed incumbent roles against this model to identify knowledge, skills, and attitudinal gaps. • Helped the client prioritize recommendations to develop a risk culture implementation roadmap, including redefining reporting relationships, reassigning decision-making accountabilities, conducting a talent review, making changes in performance management, and reengineering the recruitment and onboarding process.	Based on our work, management was in a better position to understand and address the underlying root causes of the bank's quality, control, and risk issues. An actionable roadmap enabled the client to take immediate steps towards improving its risk culture. The program also led to an increased level of risk awareness. Improved risk metrics helped support sustainable change on a longer-term basis.

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PwC's people come together with one purpose: to build trust in society and solve important problems.

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Gain customized access to our insights by downloading our thought leadership app: PwC's 365™ Advancing business thinking every day.

"Cure for the Common Culture: How to build a healthy risk culture," PwC FS Viewpoint, October 2014.
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