[Introduction]
With the rapid behavior changing disruption of recent years, and the ongoing stream of corporate governance failures. ACCA has been digging deep into how interconnected risks such as climate change and geopolitical issues are influencing the way we approach risk management. This podcast series will look at what risk culture means and to what extent risk and accountancy professionals understand its impact on performance.

[Voiceover]
It has been a pleasure collaborating with Ted McDonald from the financial market Standard Board, and Olivia Richards from Oliver Wyman, for ACCA's research on risk cultures and banking. In this episode, we talk to them about the review on conduct and culture management information that they co chaired together in 2023, and the food for thought that it has given all types of companies. So let's start by talking about your culture and conduct in my report released earlier this year, and how it reviews the progress happening at banks when it comes to developing conduct risk metrics. So could you tell us why that came about?

[Ted McDonald]
Well, the membership of the financial markets Standards Board approached us with this request, you know, we regularly ask him, What would you like us to work on. And we try and pick on subjects where we can actually help rather than say add to the noise. And their concern was, they'd spent millions and so much time and effort on conduct and culture MI and initiatives and such like and were still getting lots of pressure from regulators and the whole stakeholder community, they didn't know where each other were, you know, they had no idea about who's doing what, where, and whether they were behind or ahead are kind of on track. So the idea was, if they could pool into the center at the FMS be what they were doing with examples of their work and reports, we could then sift through and play back to them what we saw, and that would give us an outline of where people were, and people could get that impression about where they might sit.

[Olivia Richards]
Thanks, Ted and. We had such a great response and enthusiastic one from the firms involved. In the end, I think we had about 25, firms involved. So we had the major global banks, wholesale firms, asset managers, and we asked them to send us all their underlying conduct and culture and MI dashboards so that we can see what kind of information they're really measuring. And then how do they organize that so that they can understand the insights and really report that up to management? But we also asked them to fill in this survey that covered everything from why you strategically measuring conduct and culture? How are you collecting it? How are you modeling the data? And then how's that governed to drive action?

[Voiceover]
That's great. So what kind of revelations came out that are not in the firm's financial statements and other disclosures?

[Ted McDonald]
Well, I found it surprising that diversity and inclusion and psychological safety seem to be so peripheral to a consolidated view of conduct and culture. Firms would say, Oh, yes, of course, we measure it, and we're doing whatever. But it was down the hall round the corner handled by somebody else, and not part of the culture area or the conduct area. So that caught me a little bit off guard.

[Olivia Richards]
I totally agree, actually. And what we're seeing is that firms are starting to progress along this curve from verifying control effectiveness to more about understanding cultural attributes, anything that very much covers that psychological safety and

DNI. But there's still this real focus on misconduct transgressions, or what we call the sticks, the negative behaviors that lead to events. And it's less on how employees are really achieving that the positive sides of culture.

[Ted McDonald]
Yeah, they really did focus on identifying misbehavior. But it wasn't so much a surprise, but a little bit disappointing that there wasn't more effort to, you know, get a grappling hook over the wall into culture and try and understand that area a bit more, because it's the large part of the firm that is in that space rather than in misbehavior.

[Voiceover]
So what do you think the participating firms learned from the project?

[Olivia Richards]
I think the real focus now is on the need for improvement in data and analytics capabilities. So that we move from how can we use this data to help steer to what are we actually trying to steer? What data would help and potentially how do we create some more how do we link datasets to better understand that and the major learning that we're discussing thing with banks or firms now is how to better use the datasets that they actually already have. Banks have loads of data. But it's more about how to link those together in a more systems based approach to understand the complexities of human behavior. And a part of that is really banks starting to use much more basic AI to create initial reports that use those different datasets. And then overlaying those initial reports with human expertise and human insight on conduct and culture.

[Ted McDonald]
I think firms appreciated seeing the landscape broadly, for the first time, and could get some sort of assessment of where they might sit. But I think it also sharpened the focus on what leading edge could look like. And that makes a big difference and I think a real important point is that they're realizing that they can unhitch their wagon to completing 100% of the misbehavior metrics, one might have, and spending time on the culture side, they didn't need to have every single misbehavior stat that everyone else has, because it wasn't telling you much. It wasn't improving your understanding. Whereas focusing on culture a bit more would improve your understanding of what was going on in your firm.

[Olivia Richards]
I mean, some banks have been setting up these internal behavioral science units, that's not new, but certainly some are much further ahead on that than others. And they're starting to show real progress in understanding not just that sort of negative side of behavior, but also the positive side as well.

[Voiceover]
So what do you think other stakeholders would want to know in this regard? So not just regulators, but also investors, customers, third parties? And is having more reporting requirements The answer?

[Olivia Richards]
Ted, you're an ex regulator, do you want to do on a start on that one?

[Ted McDonald]
Well, I don't think we need more regulation and reporting obligations. But I think the fact that investors in the stakeholder community generally wants to understand where firms are going, what they're doing about things, how they're trying to improve. And there's room in annual reports to talk about this. And it is far more interesting to most people than the cash flow statement, which they don't understand. They can understand changes and developments in culture. And it's increasingly appreciated that culture gives one a competitive advantage. And this is absolutely essential. So the investor

community, the asset managers in the world, I think you do well, if they paid a bit more attention to these topics as well, they do now, but they could increase it. And I think that's a positive statement of progress.

[Olivia Richards]
Yeah, and I think what we certainly saw is that a regulatory focus has pushed some banks into really understanding their data and insights more. So you've seen in the UK, Australia, in the Netherlands, there's been a real focus on culture. And that certainly flowed through into how banks think about conduct and culture themselves. So a regulatory focus, rather than more reporting requirements, would be a positive step.

[Voiceover]
So we've talked about lessons learned and not learned before. But what do you guys feel the Credit Suisse story this year has taught us that might not have been so evident before?

[Olivia Richards]
Yeh, I think what it just shows is that risk culture is really of the highest importance. And that's risk culture, obviously, right through the bank of the first, second, third line. And to really understand how your people are prioritizing their decision making to promote good business and safeguard the bank at the same time, and making sure that there's real accountability and ownership within an organization. So there's not sort of this diffused sense of responsibility. There's clear parallels as well with the Silicon Valley Bank example as well. Just the risk culture is really of the highest importance and needs to be part of management attention.

[Ted McDonald]
If you were to look at the policy and processes and procedures within Credit Suisse, you would find that they're not bad. They're reasonably well designed, reasonably clearly written, et cetera. And I think what is surprising, was the sheer gap between the policy and process and the actual behavior of staff to undermine those policies and procedures. And this is whether it first line, second line, third line or senior management or junior management. The gap was enormous and allowed to grow until you see what happened. Another point I'd make is that I think it was very honorable of the firm and the board to publish the details of the internal review that they made into these failures, it was a highly detailed confessional review, which identified problems very precisely. So well done them to provide this to industry.

[Voiceover]
And speaking of how do you think expectations of bank boards and board committees have evolved, when it comes to keeping up with the pace of disruption and change?

[Olivia Richards]
Yeh, I think this is all about that shifting the dialogue. So it's not just about defending and stopping misconduct, transgressions. But it's if you want to have sustainable performance as a firm, you need to focus on the positives as well. So shifting the dialogue towards those positive cultural attributes as well.

[Ted McDonald]
I feel a bit encouraged, you know, because when I was at the FCA, we introduced the topic of conduct, what's that, and it took boards a little while to, you know, come to terms with what it meant and how big it was becoming. And then we started talking about purpose, that took them a while to get their heads around that one. And then it was culture. And once again, it's taken some time to develop an understanding of what should be done here. What should we expect as board members, and I think that that has evolved. And if you substitute the word behavior, for culture, the eyes sort of compares the fog a little bit better. And boards are getting clearer about what they can do and what they can expect from culture initiatives. I'm encouraged.

[Voiceover]
And then in terms of moving in the right direction, let's end on what you guys think the supervisory boards are doing and where they're going on this.

[Ted McDonald]
There's quite a mix around the world in terms of conduct culture versus good old prudential regulation. But in 2012, an important paper was published, declaring that those bodies responsible for regulatory supervision really needed to raise their game and behavioral science, in order to keep pace with fast changing markets and different risks. Now, the author of that report was none other than Michael Barr, who was vice chair of the New York Federal Reserve. He is the senior person responsible for regulatory supervision. This is the man who oversaw the recent report on Silicon Valley Bank, and quickly called out his own organization's failings in its oversight of that organization. So I think that behavioral science is a useful addition to the mix of tools that we have to use. And we would do well to pay attention to that.

[Voiceover]
We couldn't have had a better episode to pave the way for ACCA's Risk Cultures and banking Special Report, which includes further insights from both Ted and Olivia, as well as other highly regarded professionals in this space. And in our next episode, we welcome PaV Gill, the Wirecard whistleblower, and Emma Perry, a member of our risk culture special interest group to talk about ensuring accountability in a world of constant disruption.

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