CHAPTER 2

ERM AND THE BANK'S CULTURE

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SCB FORUMS

"…tackle the question of how human beings recognize and respond to the probabilities they confront. This, ultimately, is what risk management and decision-making are all about and where the balance between measurement and gut become the focal point of the whole story."

—Peter L. Bernstein, Economist and Author

From *Against the Gods: The Remarkable Story of Risk*

There's a legend at Federal Express that tells of a driver who, when getting to the last drop box of the day, realized that he had no key with which to open it. Since he did not have the time to drive back to his home base to get the key and return to the drop box, ensuring that the box's contents would get to their destinations as FedEx promises, he made a quick decision. He ripped the box out of the ground, taking the box to the key rather than bringing the key to the box.

At FedEx, he's considered a hero. His counterpart at the U.S. Postal Service, if he did the same thing, however, would be considered a thief, if not a felone. FedEx and the U.S.P.S.—two companies with very similar business models, but two very different cultures.

Formula for success. *There is no secret to successful implementation of ERM in your bank. Just remember to:*

- *Match the implementation strategy to the Bank's culture.*
- *Consider the individual values of the most successful people in the organization.*
- *Work within the culture given you; do not try to change the culture.*

This chapter provides the Bank Executive with strategies for ERM implementation within the context of his or her own bank's culture. It will assist in determining the culture of the organization and give practical applications for matching the strategy for implementation with the collective values of the people in the bank.

HOW TO DEVELOP A RISK AWARENESS CULTURE

When the Executive charged with implementing ERM within the Bank sets out, chances are she thinks she's assigned the duty of developing a risk awareness culture. This could not be further from the truth. The truth is that it is an impossible task, unless she's able to start with a *de novo* opportunity or from the ashes of a company crisis.

Better to start with making the culture risk aware. There's a subtle but important distinction. Culture is a huge differentiator in the marketplace. If the company is successful, its success is due mainly because of its culture. Work within that culture. Design the ERM implementation strategy to complement it, not compete with it.

MAKING THE CULTURE RISK AWARE

It's important to note first that risk taking is a relatively new thing. Prior to the Renaissance, people were consumed with day-to-day existence: how to keep their children clothed and fed, how to survive winter, how to make a hunting expedition fruitful. In fact, risk management in those days was limited mainly to putting a fence up to keep the deer out of the garden.

The advent of risk management came with the calculation of probabilities, i.e., gambling. The prospect of getting wealthy (and hiring someone to keep out the deer) is irresistible for most people. But how does one divide, after all, CCCXXIV by MMLIII?

CALCULATING PROBABILITIES

Taking risks and risk management has to do with taking stock, measuring the risk inherent in an opportunity. Do we take this risk? Can we afford to? Can we afford not to?

The engine behind ERM is that measurement leads to improved capabilities. It is important then, in making the culture risk aware, that the Executive views ERM as a process. Any process can be measured. With measurement comes improvement.

The problem is with measurement, people become defensive, given particular cultures. They have practiced their craft and will resist any thing that reminds them of someone looking over their shoulder like they would a new hire. It is important to "type" the culture.

TYPING THE CULTURE

What type of culture do you have? Is it risk averse, risk neutral, or risk tolerant? There are several ways to type the culture. Be objective. It is easy to look at risk from your perspective and forget that the culture is the collective values of all of the people in the organization.

THE MOST SUCCESSFUL PEOPLE

What are the characteristics of the most successful people in your organization? Your culture is reflected their values and behaviors. Who gets the plum assignments? Who gets to rescue a failing initiative? Who gets an appointment with the CEO without going through the proper channels? The list you develop will tell you not only who the most successful people are in the company, it will tell you the organization's culture.

Once you are able to determine who is most successful in your organization, do they challenge the process[1]/take risks?

Do your Bank's most successful people:

- Look outside the organization for ways to improve?
- Experiment and take risks?
- Seek challenging opportunities?
- Challenge people to try new approaches?
- Take initiative to overcome obstacles?
- Ask "What can we learn?"

Anat—I'd like to use the "Challenge the Process" part of the Leadership Challenge here. I'll have to get the author's permission, though. Working on that.

Answer each of those questions with "yes," "no," or "occasionally/sometimes." A large number of yeses tell you that your organization is risk tolerant; no's indicate a risk averse culture, and the occasionally/sometimes show that the culture is risk neutral.

A PIG IN THE PARLOR

Another way to type the culture is to visualize a pig in your living room. Pigs have been the subject of nursery rhymes and cartoons, but anyone who grew up on a farm will tell you that there is little cute or redeeming about a pig in the house.

It is big, smelly, and disgusting, and if you had one in your branch lobby, you would want it out. But what if the pig was an opportunity to your operation? What would

[1] Kouzes and Postner, The Leadership Challenge – need reference info.

you do? Would you throw it out or try to make it work? Your answer to those questions also indicate whether your organization is risk averse, neutral, or tolerant.

STRATEGIES FOR BUILDING RISK-AWARENESS

Chances are good that the Bank Executive finds himself in a risk tolerant culture, particularly if that bank is successful. If the organization was not prepared to take risks, it would not open its doors in the morning.

RISK-AVERSE STRATEGIES

A risk-averse culture will see ERM as a way to focus on the threats to the bank's business. Internal communication should zoom in on corporate scandals such as those that occurred at Allied Irish, Barings, and Riggs. All of the strategies to push ERM throughout the culture should center on:

- Removing or neutralizing a threat.
- Adding controls and measures.
- Regularly reporting on the ERM initiative.
- Elevating the role of Internal Audit within the organization.

In a risk-averse organization, the pig in the parlor would be driven out immediately and at all costs. The caution to the ERM executive is that sometimes, in a risk-averse organization, people will see a pig when there is no pig. And they also might see an undesired pig when something is very acceptable to keep in the system.

RISK-NEUTRAL STRATEGIES

A risk-neutral culture is not as quick to move on a real or perceived threat. It would take the posture: Is a pig a bad thing? It might work well within the organization. Can we form a task force to find out? It the pig something we can live with? What if the CEO likes the pig?

ERM strategies in a risk-neutral company are a bit more challenging. The Bank Executive must make the ERM initiative about:

- Proving that ERM is not a regulatory exercises but a business strategy (see Chapter 1).
- Connecting ERM with not only SOX, GLBA, and FDICIA, but also with everything the company does—business decisions, new products and services, hiring key executives, etc.

Risk-Tolerant Strategies

A risk-tolerant culture presents the biggest challenge of all: it may not see the pig. In this case, the Bank Executive should forget the threats to the organization and turn her attention to:

- Finding the competitive advantages and economic incentives ERM brings to the organization.
- Designing systems that will keep regulatory agencies and corporate insurers comfortable.
- Take the opportunity to show how more sophisticated approaches to managing risks will delight shareholders, ratings agencies, and Wall Street.

Tone at the Top

Anat—Introduction mentioning why is ERM so important? If the Bank Executive had just one shot at "selling" ERM to management, what should she do?

Your CEO

Anat—could you provide some sageous wisdom on the influence that a CEO has in making an initiative happen?

The Board of Directors

Anat—Please comment on the direction that the Board should provide. How involved should they be in ERM?

Anat—anything else?

Chapter Summary

ERM and the Bank's Culture

Key Points

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Gigerenzer, Gerd. *Calculated Risks: How to Know When Numbers Deceive You.* New York: Simon & Schuster, 2002.

"The Customer Comes Eighth" --need reference info

Kouzes and Postner. *The Leadership Challenge* – need reference info

Culture article from Forbes – need reference info

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