ACCA

RISK CULTURES AND BANKING: WHERE NEXT?

Think Ahead

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RISK CULTURES AND BANKING: WHERE NEXT?

This special report looks at what risk culture means for the banking industry as it faces major structural and macroeconomic shifts in the midst of thinning capacities to adapt. Building on findings from ACCA's wider report, *Risk Culture: Building Resilience and Seizing Opportunities* (Johnson 2023), and our ongoing quarterly Global Risks Survey, we examine how the already heavily regulated financial services sector has responded to the changing tides of the past year, from liquidity woes and corporate collapses to rising interest rates and consequential gains. Through our regional roundtables and one-on-one discussions with ACCA members working at and with banks around the world, we explore the path ahead for this industry and the different roles our profession plays in paving the way forward.

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Guest preface

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A healthy respect for the need to understand and navigate risk as well as an aspiration to be suitably mindful and proficient at doing so is now both a personal and organisational imperative. This fact has been underlined by years of misadventure across industry generally but dramatically so once again with the failures of major financial institutions.

The concept of navigation rather than avoidance is appropriate because risk management is about enabling good things to happen as much or more so than ensuring that bad things do not. The dynamics of risk have more to do with the infinite variety of human behaviour than the statistical probabilities of trouble generated by a mathematical model. It is all too clear that trying to make sense of a complex, rapidly changing world requires far more than a dedicated risk function can provide.

Catastrophes in financial services like Archegos and Silicon Valley Bank are arguably explained more by failings of staff behaviour at various levels than by flaws in policy drafting or process design. The failings also extended far beyond the typical organisational footprint of Risk and Compliance functions. A strong partnership between Risk, other support units, and especially the accounting functions can make a big difference.

Behaviour versus culture

The term 'culture' is often cloaked in swirling adjectives and sweeping generalisations. However, it can be quickly elevated above this fog by focusing on the relevant behaviours that underpin key principles and values of a firm, a profession or the specific objectives of a risk control process. Individual behaviours support the achievement of desired outcomes. The combined term 'risk culture' can similarly be elevated when the focus of attention is on key behaviours that matter.

The financial services industry recently took a step back to assess its progress in developing effective management information on conduct and culture. It found that it was not spreading its attention widely enough or sufficiently addressing specific, unhelpful behaviours. It is now taking steps to address this. These lessons in the recent report from the Financial Markets Standards Board can effectively apply to industry in general (FMSB 2023).

Networking and telling the story

Risk and Compliance teams, often reporting together to the chief risk officer (CRO) in larger banks, operate essential control and support infrastructure and have deep connections across the whole organisation. Also in financial services, the chief operating officer (COO) oversees another highly connected organisation with access to very useful information. But the staff members with perhaps the greatest network of all are in the finance and accounting functions. Their roles typically have them engaging throughout the whole organisation placing them in a prime position to compare or notice differences within operating units or when looking across functional boundaries. As well as compiling numbers, this enables accounting staff to gather and then relate insightful observations or stories about how and why things are actually done.

We have a comfortable habit of describing the evolving story of an organisation solely with numbers that assess its growth, revenues, profitability and for some, quarterly earnings per share. But the important human story of the company is much broader and revolves around personal and organisational development, community, market impact, resilience, skill development and much more. Numbers do provide a sense of order, but stark numerical simplicity barely scratches the surface. Internal reporting should seek to elevate the broader story in clear and accurate terms. It should bring to life the story behind the numbers with decision-useful context. This is a worthy challenge.

Enhancing collaboration and breaking down silos

We live with a constant inflow of information, but it is often devoid of challenge or diversity of opinion. This environment breeds risk rather than enabling teams to address and mitigate it. Collaboration is often relegated to being just a process of seeking input from additional people accompanied by worthy attempts at inclusivity. In fact, collaboration is a full dimension of character like drive, courage, justice and accountability. It is an essential area for personal as well as organisational development if we are to make more sense of developments in a timely fashion. This is simply vital to the accounting functions.

Risk and accounting professionals could well become super-networkers and conveners, helping teams to make good judgement calls, and addressing the need to share knowledge within the organisation as well as externally. Ultimately, all the support functions need to raise awareness, promote new information and effectively influence each other and the rest of the organisation. Stories can help do that and the accounting profession is perfectly placed to contribute significantly.

Ted MacDonald, senior technical specialist, Financial Markets Standards Board

RISK AND ACCOUNTING PROFESSIONALS COULD WELL BECOME SUPER-NETWORKERS AND CONVENERS, HELPING TEAMS TO MAKE GOOD JUDGEMENT CALLS, AND ADDRESSING THE NEED TO SHARE KNOWLEDGE WITHIN THE ORGANISATION AS WELL AS EXTERNALLY.

Executive **summary**

The banking collapses in 2023 highlighted the need for greater transparency on issues leading to operational losses and reputational risk at banks, which as a consequence is what a strong risk culture supports. Trusted information is crucial for building resilience and prudential risk taking in the financial services industry, and throughout this report we discuss how accountancy professionals can serve as risk culture super-networkers, aiding teams in making informed decisions and sharing knowledge within and outside the firm. By telling the stories, our profession can raise risk awareness, promote new insights, and effectively influence the performance of the organisation.

Learning lessons and paving the way forward

As green and digital transitions only further increase stakeholders' expectations, how banks and their regulators learn from the 2023 collapses might prove to be one of the most critical chapters in a lifetime for the financial services industry. From a risk culture perspective, ACCA members from banks around the world have emphasised the importance of gaining a fresh, more vigorous perspective on 'accepted non-financial risks'.

Credit Suisse admitted 'material weaknesses' in its internal controls over financial reporting and risk assessments in 2022 and 2021, which related to the failure to design and maintain an effective process for identifying the risk of material misstatements in its financial reporting. The Swiss Financial Market Supervisory Authority's December 2023 report on the lessons learnt from the crisis also stated that although Credit Suisse satisfied regulatory capital requirements, they were not enough to prevent the bank's demise. The message from ACCA members worldwide in this industry was clear-cut: while greater dialogue between banks and regulators is needed, there is a complexity that is fast becoming recognised as a 'must tackle' for successful bank risk cultures and that is behavioural science.

The rise of behavioural metrics

Risks have become so widespread that many ACCA members from banks use the words 'threats' or 'hazards' instead, and say it makes sense to focus on the behaviours behind the risks because behaviour is something you can measure, monitor, and strengthen. Adopting a more behaviourally informed approach to understanding risk requires acknowledging the key part of the environment in driving behaviour and accepting deeper systemic root causes. For managers this means adopting an approach that reinforces their own responsibility and places their own attitudes under the spotlight too.

Understanding the blind spots and reasoning that can cloud management's vision, and investing in informed behavioural-risk methods, are all very critical to crafting a successful approach to risk management. Unique among risks, behaviour is influenced by numerous powerful biases that are formidable obstacles to creating a successful risk culture. The first step is to recognise this.

Perspectives of accountancy professionals at banks

We discuss how accountancy professionals in various roles at banks have become more focused on helping turn risk management into a value-added mindset, helping institutions meet their objectives, especially those related to the sustainability agenda, and this includes ensuring the integrity of environmental, social and governance (ESG) reporting. However, respondents working in risk roles often expressed frustration about not having the necessary buy-in and investment during such pivotal times.

Members explain how risks are increasingly influencing and exacerbating one another, with many CROs and risk heads also pointing to growing geopolitical complexities manifesting through supply chain disruptions, ransomwares, and third-party threats. Through our quarterly Global Risks Survey we see how political instability typically concerns financial services respondents through the 'technology, data, and cybersecurity' lens, while individuals working at non-financial corporates perceive such concerns more as 'business-critical' risks, ranging from transportation issues to customer service and reputation risks.

Leadership setting the course – for success or failure

It is important to consider the leadership risk perspective and how this influences the definitions, decisions, approaches, and reactions to a bank's risk culture. Several participants in our banking roundtables also brought up the notion of how the risk disposition of their leaders may affect performance, and we found a growing body of literature on this subject given the amount of accessible external data about banks and the backgrounds of their executives. Understanding how different team leaders across the organisation think about risk – for example, what is acceptable and what is not – helps major decision makers influence the organisational behavioural change needed to achieve goals and turn the dial in the right direction.

Additionally, we found that middle managers who understand how different people on their team deal with risk are better at capitalising on the various individual strengths of each team member. The point is that strong leadership involves an appreciation of perspectives that challenge and complement each other in a way that creates value and sustainable investment returns.

AI is changing the banking industry faster than meets the eye

Unsurprisingly, the report highlights the significant impact of AI on banking, particularly in risk management and the insights it provides. By the end of 2023, some banks were exploring ways to identify conduct risks using unstructured data from various communications channels, including advanced analytics to detect previously unsuspected behavioural issues and patterns. These advancements provide highly productive and predictive capabilities, but they also have potential unintended consequences.

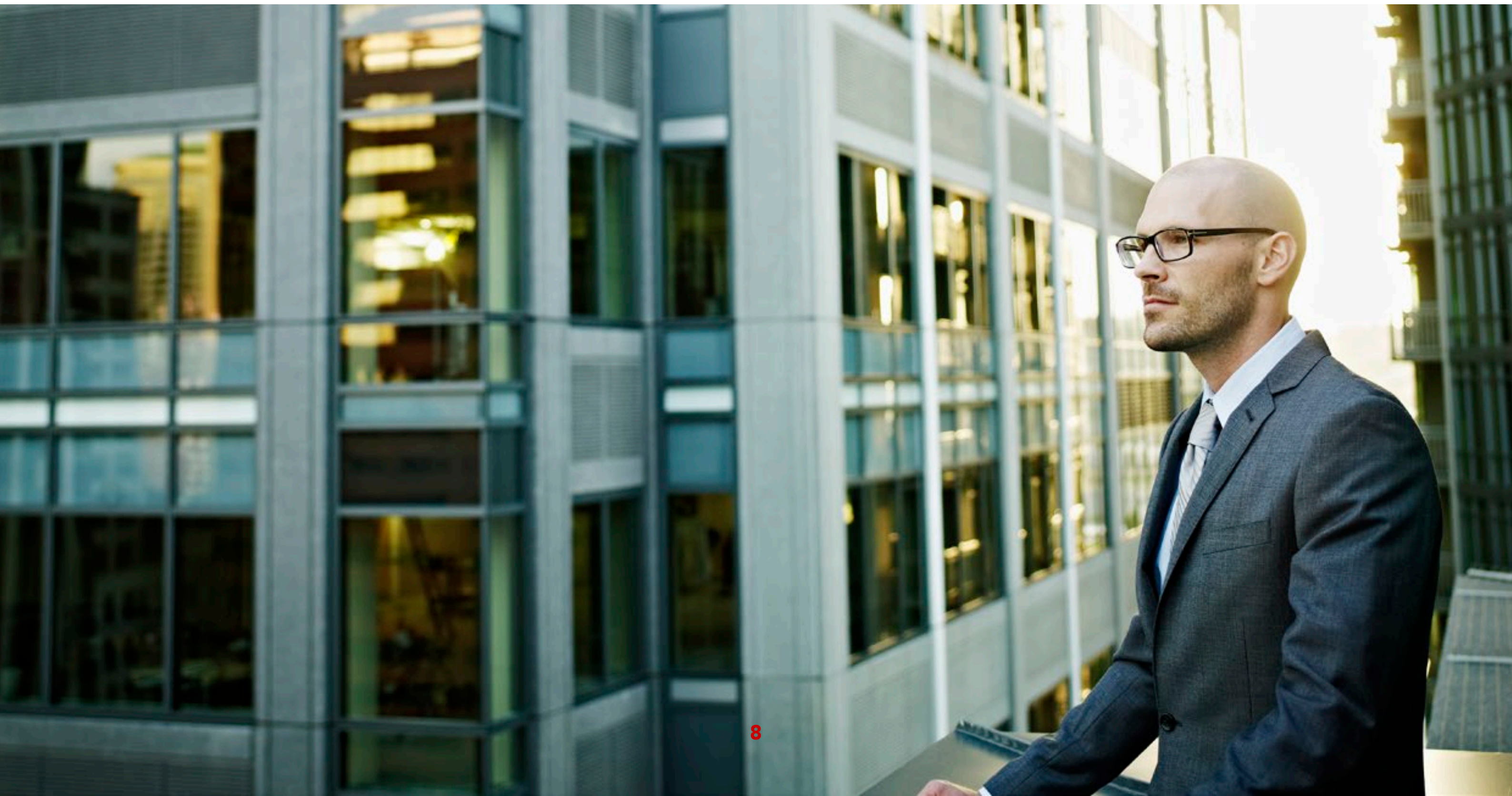
ACCA members emphasise the importance of considering both existing and new use cases together, as understanding the desired outcomes and unintended consequences is crucial for stakeholders and shareholders. In the near term, new technologies like chatbots are emerging, and we found several banks configuring various versions of their own in-house. The value of these technologies lies in their true integration into business processes, and it will take time for the risk and compliance community to ensure they operate as expected. Accountancy professionals can strike a balance between numerical data and what is happening in practice, which is essential for decision making and maintaining trust during rapid transformation.

Accountability and collaboration across the three lines

The report also delves into how organisations enhance collaboration and decision making across the 'three lines' – where risk and accountancy professionals come together. We explain how institutions can ensure that accountability is embedded across teams by deploying structural 'drivers', reinforcing core actions so that senior leaders are ultimately accountable for outcomes within their remit.

Our ongoing discussions about the evolving relationship between risk and ethics continues to shine a light on how this is being integrated across the three lines. Through our banking roundtables, we discover examples of dedicated teams of ethics practitioners being formed to define policies that help mitigate cultural and governance risks.

Building a strong risk culture requires a collective effort, with every employee embracing accountability as a fundamental set of three behaviours: understanding, acting, and recording. By implementing these drivers and activators, institutions can mitigate emerging risks and foster a healthily balanced risk culture.



Ten action points for banks

Our special report on risk cultures in the banking industry includes a list of key takeaways at the end of each chapter to help risk and accountancy professionals take action.

1. Accountancy professionals have a crucial role in delivering effective risk culture within organisations, prioritising value and risk management even amid cutting costs.

2. Responsible accounting for operational risk and non-financial risks requires precise measurement, transparent reporting, and continuous improvement in risk management practices.

3. Risk and financial leaders must demonstrate awareness of risk culture as a critical risk governance concern and cooperate with regulators about what constitutes good behaviour.

4. As banks put more focus on prioritising risks and identifying behavioural patterns, accountancy professionals can help senior management understand and promote positive behaviour more strategically.

5. Senior management must be aware of blind spots and biases that can hinder their approach to risk culture and should assess their preparedness and knowledge of risks and opportunities in addressing cultural concerns.

6. Understanding different perspectives on risk taking is crucial for decision makers to influence behavioural change, and shadow boards and employee task force groups can make a profound difference.

7. Risk and financial professionals must convene with other teams to address the challenges posed by the AI paradigm shift and ensure the safe and ethical use of AI.

8. The three lines have inevitably been blurred by the disruption of today's dynamic risk landscape. This necessitates greater collaboration, agility and innovation for effective risk governance.

9. Accountability is essential in preventing bank failures, and businesses should incentivise and quantify a risk culture that involves everyone in the organisation.

10. ACCA professionals should fulfil their job requirements confidently, emphasising vigilance, accountability, and ethical practices to prevent further scandals.

1. Prioritising culture and governance

The banking turmoil in the first quarter of 2023 has thrust bank risk management back into the limelight, exposing cultural and governance cracks that would make any sort of organisation exceedingly vulnerable, especially with today's tsunami of change and uncertainty. Banks are in the business of taking on risks, so the necessity of fixing these blind spots before another crisis arises is self-evident. Indeed, as the green and digital transitions only further increase stakeholders' expectations, how banks and their regulators learn from the 2023 collapses might prove to be one of the most critical chapters in a lifetime for the financial services industry.

The chain of collapses

The collapses of First Republic Bank, Silicon Valley Bank (SVB) and Signature Bank during the first quarter of 2023 were the second-, third-, and fourth-largest bank failures in US history, respectively, smaller only than the collapse of Washington Mutual during the Global Financial Crisis (GFC) in 2007 to 2008. Credit Suisse, which since 2011 had been on the *'List of Global Systemically Important Banks'* (G-SIBs) published by the Financial Stability Board (FSB 2022), was brought down by a succession of scandals, including the bankruptcy of Greensill Capital, the supply-chain financing business to which it had lent billions of dollars, and the fall of family office Archegos Capital, which resulted in massive trading losses (FSB 2023b).

Credit Suisse's toxic culture was exposed by a series of incidents demonstrating reckless risk taking and lack of adherence to controls, and its reputation was tarnished to the point that stakeholders lost all confidence. The demise of all these different types and sizes of banks is all too typical of what has been seen before, with the hedge fund, Long Term Capital Management (LTCM), Halifax Bank of Scotland (HBOS), Northern Rock, Lehman Brothers, America International Group (AIG), and financial services company Wachovia, among other notorious examples, all of which had profound impacts on the economy. Lest we forget, the LIBOR (London Inter-Bank Offered Rate) and ING bank scandals, which also highlighted cultures of collusion, lax controls, inadequate customer due diligence and utter lack of transparency and accountability.

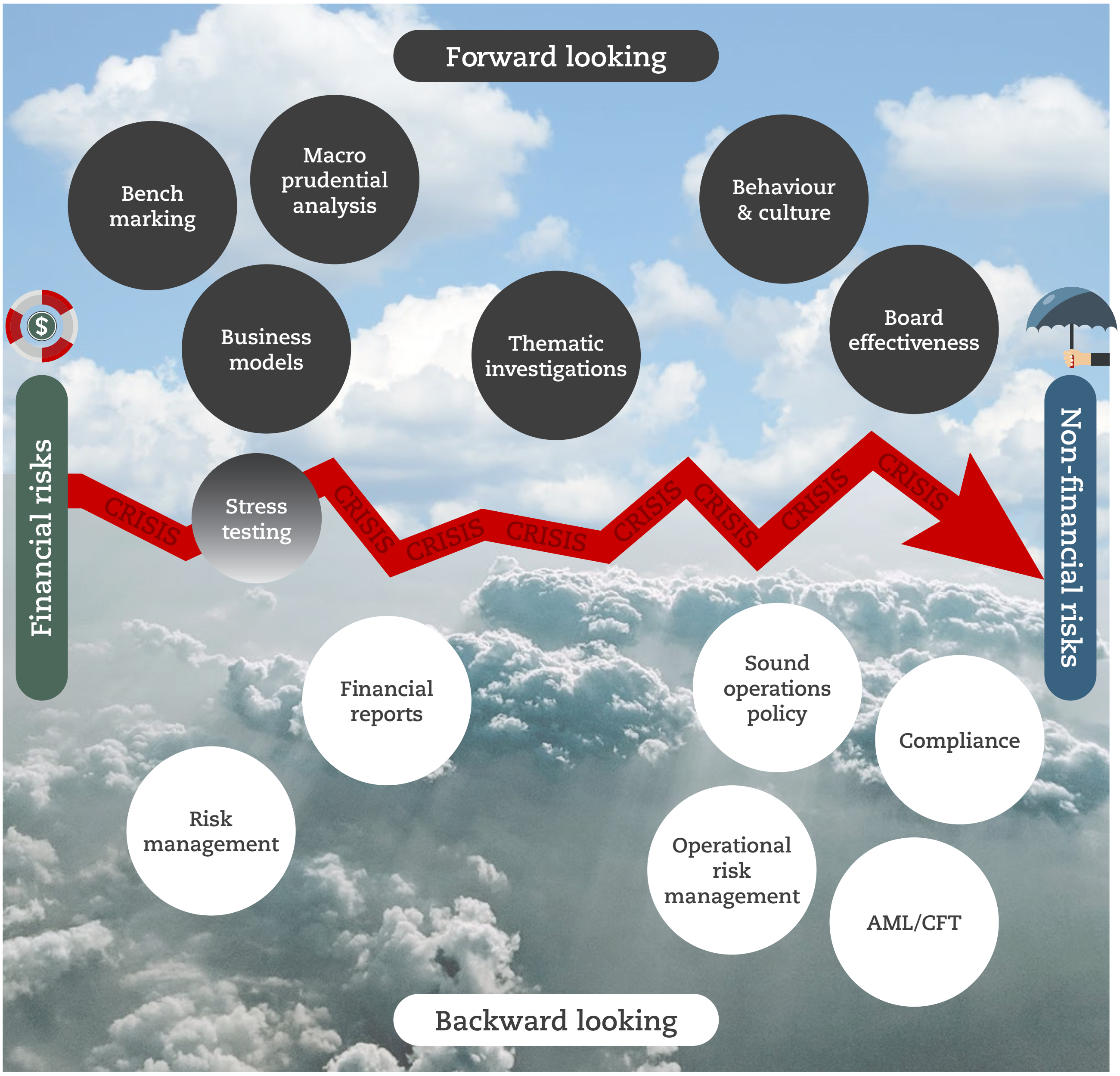
Pablo Hernández de Cos, the chair of the Basel Committee on Banking Supervision and governor of the Bank of Spain, put the 2023 collapses into context in a speech at the Eurofi Financial Forum on 14 September 2023, explaining that it was the most significant system-wide banking stress event since the GFC in both scale and scope:

> *'To give you a sense of the order of magnitude, the total value of these banks' assets is roughly equivalent to Spain's annual GDP, leaving aside the stock versus flow nature of these numbers.'*
> **(Hernández de Cos 2023)**

The sheer speed of the collapses within such a short time – accelerated by the omnipresence of social media – showed how banks not identified as G-SIBs can still be systemically crucial and cause contagion and stress across the financial markets. The failure of a fifth bank with around US$230bn in assets occurred on 1 May 2023. So, the inescapable question now is what risk culture and governance improvements do we need to make to avoid future crises?

> **THE INESCAPABLE QUESTION NOW, IS WHAT RISK CULTURE AND GOVERNANCE IMPROVEMENTS DO WE NEED TO MAKE TO AVOID FUTURE CRISES?**

FIGURE 1.1: What is risk culture?



Source: adapted from Dr Roger Miles

RISK CULTURE IS A TERM DESCRIBING THE VALUES, BELIEFS, KNOWLEDGE, ATTITUDES, CONDUCT, BEHAVIOURS AND UNDERSTANDING ABOUT RISK, AND THE LEVEL OF ACCEPTED RISK SHARED BY A GROUP OF PEOPLE WHO HAVE A COMMON PURPOSE.

Reactions from regulators

While the markets seemed to move on, key bank regulators churned out a string of assessments of the collapses during the second half of 2023. The Basel Committee on Banking Supervision (BCBS) digested the many flaws it found in its Report on the Banking Turmoil of 2023, including lessons that regulatory and supervisory bodies must learn (BCBS 2023a).

> *'fundamental shortcomings in basic risk management of traditional banking risks, such as interest rate risk and liquidity risk, and various forms of concentration risk;*
>
> - *a failure to appreciate how various risks that were building up were interrelated and could compound one another;*
> - *inadequate and unsustainable business models, including an excessive focus on growth and short-term profitability (fuelled by remuneration policies), at the expense of appropriate risk management;*
> - *a poor risk culture and ineffective senior management and board oversight; and*
> - *a failure to adequately respond to supervisory feedback and recommendations.*
>
> **(Hernández de Cos 2023)**

In its own review of the events of March 2023, the FSB focused on the effective operationalisation and implementation of its Key Attributes of Effective Resolution Regimes for Financial Institutions, which raises many discussion points on the social licence of banks amidst eroding public trust in them. (FSB 2023b).

Reflections from ACCA members

ACCA's risk culture research continues to see an 'everything, everywhere, all at once' environment where even the most well-capitalised banks find it difficult to understand how behaviours towards and attitudes about risk affect the overall health of the firm.

> *'We see time and time again that boards and senior management are more concerned with quarterly earnings and do not pay enough attention to strategic risks and how fast they materialise into something very costly.'*
>
> **ACCA member, UK**

See AB article, 'Are leaders risk-ready?' (December 2023).

> *'We have already talked about the case for strong risk cultures, so now with more cost cutting and restructurings the question for us as a profession is "how do we help financial institutions – and their regulators – restore trust and do more to prevent something systemic from happening in an already shaky global economy?"'*
>
> **A member of ACCA's 'Global Forum for Governance, Risk and Performance'**

ACCA's major report from April 2023, *Risk Culture: Building Resilience and Seizing Opportunities* (Johnson 2023), includes 10 calls to action to help risk and financial leaders use risk culture as a competitive advantage in navigating the stormy waters. ACCA's report, *Internal control and the Transformation of Entities* is also relevant reading (Webb 2022).

ACTION POINTS

Risk culture is central to how any organisation is led and managed, and accountancy professionals play an integral role in delivering an effective risk culture. This is because their access to information and influence over major decision makers is key to getting any aspect of an organisation to where it and its stakeholders and shareholders want it to be.

- As organisations attempt to embed risk into strategic decision making across all activities, accountants should ask themselves what areas take priority and what adds value for their organisations eg if we need to cut costs, can we still manage and take on risk effectively?
- The complexities of banks' business models mean accountancy professionals should be reviewing conflicts with stated values and deciding whether opportunities are in line with desired behaviours. Accountancy professionals should also be explicitly tasked with reconciling ethics with profits, especially during times of rapid change and uncertainty.

Managing risks relating to trust: the biggest blind spot of all?

Risks emerge rapidly, transform, morph and express themselves as reputational, market, credit and operational risks. For these consequential risks, apart from reputational risk, banks hold capital. No (regulatory) capital measure seems to be available for reputational risk.

This is a huge shortcoming as reputational risk, stemming from a lack of trust by parties with an interest at stake, can have devastating effects, as financial history shows time and again. Indeed, stakeholders have the power to make or break, and so appropriate management and oversight of risks, most of which exist well-outside the classical Basel-regulatory categories, are required.

This is especially true for trust. The question of trust can be raised in different contexts: is there harm from activities, what moral or legal duties exist, are any legal or moral rights being violated, and is there fairness, honesty and respect? When stakeholders react negatively to those questions, resources, such as capital, talent, genuine support and goodwill, may be withdrawn from a bank. Given the role of banks in society, it is vital to avoid this whenever possible. Whether this is acknowledged or not, demands on bank's boards are greater than ever before, and achieving sound governance nowadays is not for the faint hearted.

How can governance be improved?

Boards need relevant experience, up-to-date knowledge and moral aptitude so they can exhibit responsibility for all stakeholder needs. Governance bodies must include appropriate representation of all the interests at stake and boards of directors need to exhibit responsibility for those changing interests at all times.

Additionally, governance bodies must be mindful of their legal and moral fiduciary obligations and how they are supported by an appropriate corporate culture, structure and processes. Decision making in banking needs to include not only financial and legal considerations, but also ethical considerations. A proper ethical analysis, separate from people's personal opinions derived from the environment in which they were socialised may help to navigate ethical risks and achieve corporate aspirations. Decision making quality can improve by mutual communication between stakeholders and corporate staff through the governance bodies, thereby lowering risks of breach of trust.

By **Dr Eelco Fiole**, CFA, Fellow IoD is co-founder (2015) and Managing Partner of Alpha Governance Partners (alpha-gp.com), a fiduciary risk governance partnership, and adjunct professor Finance Ethics at the Universities of Lausanne and Neuchâtel. Dr Fiole worked almost three decades in banking and finance, of which a decade was as CFO and COO.

2. Rethinking operational risk quantification

The 2023 annual report by ORX, an international association of operational risk specialists, presents us with further reason to consider how we improve the way banks measure and manage non-financial risks since it shows that operational risk loss events in the financial services industry have spiked back up after having been in decline since 2017 (ORX 2023), with misinformation, cyber warfare and data breaches on the rise.

An ACCA member who is an investment manager in the UK compared the accumulating operational risk losses at banks *'like trying to extinguish forest fires'*. He further commented:

> *'The fines and reputational damage in banking have been enormous in recent years. It is as if we know something needs to change about how we quantify these risks but, as an industry, we are not doing enough about it.'*
> **ACCA member, UK**

In one roundtable, Milena Olszewska-Miszuris, an ACCA member who runs a boutique board advisory and is co-founder of the 30% Club in Poland, referred to the misconduct lessons still not learnt from the collapse of Polish fintech GetBack (Fitzgeorge-Parker 2018). She pointed out:

> *'Composition of the audit committee is essential in ensuring the financial statements are responsible, and the majority should be independent, not for box ticking where you fulfil legal or best practice obligations but rather for true independency where you do not have material relationships with the company, the founders or key shareholders.'*
> **Milena Olszewska-Miszuris, ACCA member**

Olszewska-Miszuris, who is also a member of ACCA's 'Global Forum for Governance, Risk and Performance' and sits on the Corporate Governance Committee at the Warsaw Stock Exchange, added: *'For me, it's very important to be able to link financial statements to what the firm is doing, and I would emphasise that professional scepticism is one of our greatest, most powerful weapons'*.

In addition, we see academics speaking more strongly about the need for boards and senior management in the banking industry to get a tighter grip on such non-financial risks. Tom Butler, a professor at the Cork University Business School in Ireland, says no other types of organisations are prepared to accept the level of losses on a regular basis that banks do, and that there could be more integration of non-financial risks at the board level given today's dynamic risk environment.

'Not enough effort has gone into identifying objective risk indicators across the financial services industry even though the technology is there to do it, not just with AI and machine learning, but also advancements in risk software,' he told ACCA. He spells out the necessary IT infrastructure required for improved risk management in a paper he co-authored for the Journal of the Society for Risk Analysis *Time for a paradigm change: Problems with the financial industry's approach to operational risk* in October 2023 (Butler and Brooks 2023).

Peter Hughes, a visiting fellow at the Durham University Business School who leads research into risk quantification and reporting systems and who is a member of ACCA's 'Global Forum for Governance, Risk and Performance', believes that codifying new methods of non-financial risk quantification is the way forward. *'We should ask ourselves whether these failures could have been prevented if risk management systems were in place that systematically quantify, aggregate and report accumulating exposures.'*

Mind the gaps

ACCA members from banks have been clear that greater transparency on issues that lead to operational losses and reputational risk, such as seen in 2023, is a must for building resilience and prudential risk taking.

SVB elevated the case for gaining a fresh, more vigorous perspective on 'accepted non-financial risks' and how we account for them (Hughes 2023). Credit Suisse itself publicly admitted 'material weaknesses' in its internal controls over financial reporting and risk assessments in 2022 and 2021 in its last annual report published in March 2023. It stated that these related to the *'failure to design and maintain an effective process for identifying the risk of material misstatements in its financial reporting'*.

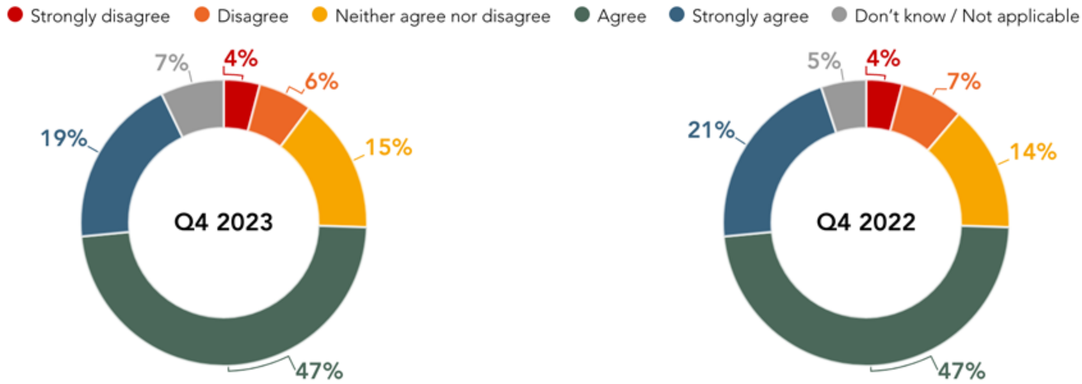
ACCA MEMBERS FROM BANKS HAVE BEEN CLEAR THAT GREATER TRANSPARENCY ON ISSUES THAT LEAD TO OPERATIONAL LOSSES AND REPUTATIONAL RISK, SUCH AS SEEN IN 2023, IS A MUST FOR BUILDING RESILIENCE AND PRUDENTIAL RISK TAKING.

Yet perhaps the most convincing statement came from the Swiss Financial Market Supervisory Authority's December 2023 report on the lessons learnt from the crisis, which said that although Credit Suisse satisfied the regulatory capital requirements, they were not enough to prevent the bank's demise. (FINMA 2023)

In our research, ACCA members referred to regulatory capital requirements as an ongoing issue and said that there is intensifying debate about how we explicitly quantify and aggregate such risks. *'You have all these questions about how much bank capitalisation is required to cover risk, and this could be completely inadequate or over-adequate,'* commented another ACCA member who is head of operational risk at a bank in London. Metro Bank in the UK is another a prime example, since it had to go to the market to raise the £600m of extra capital it needed to meet capital requirements (Venkataramakrishnan and Noonan 2023).

Currently, Basel IV's treatment of operational risk models displays a narrative of tension between standardisation and the intrinsic complexity of operational risks. *'While the standardised approach aims to bring clarity and comparability, it grapples with the challenge of adequately capturing the unique risk profiles of diverse financial institutions. The shift away from internal models prompts a re-evaluation of the sophistication and granularity of risk management practices. As the regulatory landscape continues to evolve, the issues surrounding operational risk models serve as a reminder that the pursuit of standardised frameworks must be tempered with a nuanced understanding of the intricate risks that financial institutions navigate. The journey toward Basel IV underscores the ongoing dialogue between regulators and the regulated, seeking a delicate equilibrium in the face of ever-changing financial realities,'* Mark Dougherty, co-founder and head of risk advisory and risk education, RiskTAE Limited, cogently sums it up.

FIGURE 2.1: Nearly a third still do not believe their organisation's risk culture is aligned with what is says it does in its publicly states commitments, eg annual reports – **Q4 2023 vs Q4 2022**



Source: ACCA/IMA Global Risks survey (2023)

ACTION POINTS

Responsible accounting for operational risk-related losses and all other non-financial risks requires a comprehensive and integrated approach.

- It involves precise measurement, transparent reporting and a commitment to continuous improvement in risk management practices. Financial institutions that embrace responsible accounting go beyond traditional financial reporting and compliance.
- Responsible accounting for unexpected operational losses using modern-day risk management techniques requires a bank's accounting records to have a complete audit of both internal risk related losses and their impact on society and the environment – and moreover it entails making them transparent.
- Accountancy professionals in all their different roles should always seek alternative information sources, dig deeper and engage with other functions to gain multiple perspectives on data. It also makes sense to stay up-to-date on the financial statements of peer organisations.

Basel IV: What's in a name?

Originating from the city of Basel in Switzerland, the Basel Accords have been the cornerstone of global banking supervision and regulation for several decades. The name 'Basel IV' has emerged as a colloquial term, referring to the evolving framework of banking regulations that succeeded Basel III, and is not without its nuances, controversies and implications[1] (Dubois 2023).

The term is not officially used by the Basel Committee, but refers to the cumulative impact of several regulatory enhancements rather than a standalone set of regulations. Irrespective of the terminology, the Bank for International Settlements (BIS) and its BCBS are introducing new and burdensome requirements, making 'Basel IV', now part of the regulator vernacular, the most comprehensive transformation package in the history of Basel regulations.

To add more confusion, the British government has called the developing regulations 'Basel 3.1', while some in the US refer to it as 'Basel III Endgame (B3E)' because 'Basel IV' (whatever different parties call it) represents a sea change for banks globally and significantly alters the regulatory capital regime for US banks.

'Basel IV' modifies how banks think about regulatory capital and imposes more granular and rigorous requirements on them. Meeting these requirements and building on them to improve understanding and management of business and profitability will require an enterprise-wide effort.

In the European Union, 'Basel IV' changes will be completed under the Capital Requirements Regulation (CRR) III and Credit Requirements Directive (CRD) VI. One key component often associated with the notion of 'Basel IV' is the Fundamental Review of the Trading Book (FRTB), which breaks from current practice where market risk capital requirements are known as 'Basel 2.5'.

The FRTB framework requires banks to align their internal models more closely with the regulatory standards and introduces a revised standardised approach for calculating market risk capital. Another contribution to perceptions of 'Basel IV' is the current work on the standardised approach for credit risk, also known as the Revised Basel III Standardised Approach (RBSA). Other changes include those for company voluntary arrangements (CVA), the leverage ratio, and Pillar 3 reporting requirements.

Critics argue that 'Basel IV' compliance will likely require a significant increase in capital and should be treated as a distinct round of reforms being introduced by the BIS and its BCBS. This is a complex tapestry of challenges and milestones for financial institutions worldwide.

By **Mark Dougherty**, co-founder and head of risk advisory and risk education, RiskTAE Limited, London, UK; and, **Paul Virno**, risk consultant, RiskTAE Limited, London, UK

1 The development of Basel regulations began in the mid-20th century when the BCBS was established. Basel I, introduced in 1988, set out the first set of international capital standards. It was a relatively simple framework, primarily focusing on credit risk, and served as a foundation for future developments. Basel II, implemented in the early 2000s, aimed at refining and expanding the regulatory framework, incorporating more sophisticated risk-measurement approaches. As the financial crisis of 2007–2008 unfolded, revealing weaknesses in the regulatory framework, Basel III emerged as a response, intended to enhance the stability and resilience of the global banking system. Basel III introduced stricter capital requirements and new regulatory instruments, and placed a greater emphasis on risk management and transparency.

3. The regulatory conundrums

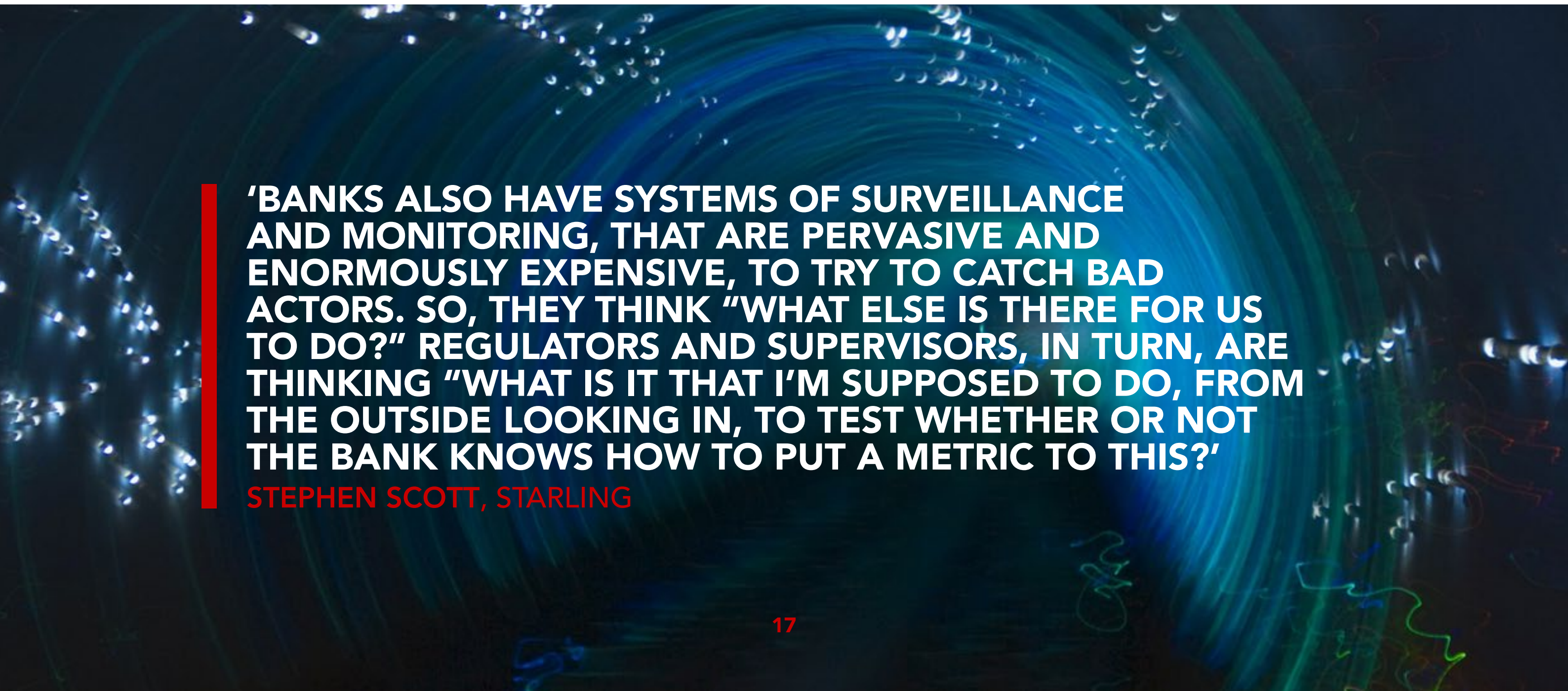
The clear-cut message from our conversations with ACCA members and the supervisory bodies around the world is that more dialogue is needed between banks and their regulators. There is not a lack of willingness but rather a complexity of an area that we see fast becoming recognised as a 'must tackle' for successful bank risk cultures – behavioural science.

'The expression I hear from many people in officialdom is that we have done everything we can think of from engagement surveys, pulse surveys to exit interviews and townhall meetings to try to set the right tone from the top. Banks also have systems of surveillance and monitoring, that are pervasive and enormously expensive, to try to catch bad actors. So, they think "what else is there for us to do?" Regulators and supervisors, in turn, are thinking "what is it that I'm supposed to do, from the outside looking in, to test whether or not the bank knows how to put a metric to this?",' said Stephen Scott, founder and chief executive officer of Starling, as well as a member of ACCA's special interest group on risk culture.

He added: *'Just before the CEO of Wells Fargo appeared before Congress, a television pundit asked him, "why would people behave like this?" and he threw his hands in the air. The CEO said he can't explain human behaviour. I think that's a sentiment that would resonate for a lot of people who are very well-intentioned and in positions of leadership. Being able to explain human behaviour is an important thing, but when I did my MBA that was not a big part of the curriculum. Now we see regulators around the world twigging to the idea that if we're thinking about behaviour issues, then maybe behavioural science has something to offer'.* (Merle 2020) See also Starling Insights' *Changing Banking for Good* report (Starling 2023).

Dr Mirea Raaijmakers, a main architect of the pioneering approach of behaviour and culture supervision at De Nederlandsche Bank (DNB), as well as the global head of behavioural risk management at ING Bank for five years, explains how regulators could be more 'up close and personal' with banks. In episode 8 of ACCA's risk culture podcast series, she said:

> *'What I remember from those years at the DNB is that there was a lot of appreciation among board members and executives about what these conversations spelled out – the behaviours and their impacts on decision making, performance and the integrity of the institution's business.'*
>
> **Dr Mirea Raaijmakers, behavioural risk management expert**



'BANKS ALSO HAVE SYSTEMS OF SURVEILLANCE AND MONITORING, THAT ARE PERVASIVE AND ENORMOUSLY EXPENSIVE, TO TRY TO CATCH BAD ACTORS. SO, THEY THINK "WHAT ELSE IS THERE FOR US TO DO?" REGULATORS AND SUPERVISORS, IN TURN, ARE THINKING "WHAT IS IT THAT I'M SUPPOSED TO DO, FROM THE OUTSIDE LOOKING IN, TO TEST WHETHER OR NOT THE BANK KNOWS HOW TO PUT A METRIC TO THIS?'
STEPHEN SCOTT, STARLING

What regulators want versus what they do

Indeed, no other industry is expected to assess and report on risk culture more than financial services. ACCA members from banks and other financial firms have attested how they wish supervisory bodies could be clearer about what they expect in regard to detecting misconduct and developing behavioural risk indicators, while supervisory bodies have also made anecdotal accounts about the challenge to refine expectations without stifling innovation and economic growth.

Frank Elderson, a member of the executive board of the European Central Bank (ECB) and the vice-chair of its supervisory board, illuminated the outlook from a supervisory perspective in his September 2023 speech, *'Treading softly yet boldly: how culture drives risk in banks and what supervisors can do about it'.*

> *'…if we only looked at the bank's official risk management guidelines, often detailed in lengthy internal handbooks, we would be at risk of missing the crucial element of whether staff are encouraged, incentivised and obliged to take these policies seriously, or whether there is an implicit understanding that these are only "nice to have".'*
> **Frank Elderson, European Central Bank (ECB)**

Some regulators say that their meetings with bank boards and senior management find that Key Performance Indicators (KPIs) are not balanced enough between short-term, long-term and 'target' risk behaviours. In the November 2023 session of ACCA's 'CROs and Heads of Risk Forum', we discussed what banks should do with such feedback from supervisory bodies. *'Asking those front-facing executives "what are the risks in your space and how are you managing them?" is one thing, but demanding answers that make sense is another. When the front-line-facing executives proactively engage the second line for support and guidance, that's how you gauge risk maturity and progress,'* said Nino Gordeladze-O'Brien, a consultant focusing on governance, risk and compliance, who has worked as head of enterprise risk management and deputy CRO at the Bank of Georgia, LSE Listed, and before that, in the first and second lines at Westpac Banking Corporation.

Regulators continue to concentrate on psychological safety, but through our banking roundtables, forums, interviews, and open-ended survey questions, which are all treated anonymously, we found respondents, in mid-level roles especially, who do not feel comfortable speaking up if they were to suspect a problem, with many of these also expressing disbelief that action would be taken and followed through. ACCA members from banks all over the world asked if regulators could do more to recognise good behaviour, emphasising that there needs to be greater focus on how to stimulate positive risk taking, for example, through the various individual accountability regimes around the world that aim to force senior managers to take personal responsibility for risk control. We heard how banks need to gain a better understanding of the behaviours that lead to certain outcomes, including those for customers. See appendix for lists of what desired and undesired behaviours at banks look like.

The UK's Financial Conduct Authority (FCA) for one has talked about how banks must work beyond the business of profit making and ask themselves what the world would miss out on if their bank did not exist. Emily Shepperd, chief operating officer and executive director of authorisations at the FCA, touched on the social licence of banks and the intent to improve accountability in a speech in June 2023:

'… to work at a senior level in financial services, you need to pass and continue to meet the conditions of a fitness and propriety assessment. This includes consideration of honesty, integrity and reputation. And individuals have been struck off for failing to meet the threshold of being fit and proper after being convicted of offences including holding child pornography, sexual harassment, and serious violence. Not disclosing arrests or convictions can also lead to a ban. One executive received a life-long ban from us after being exposed as one of the country's most prolific rail fare dodgers,' she explained (Shepperd 2023). The FCA has detailed requirements for fitness and propriety (FCA 2023).

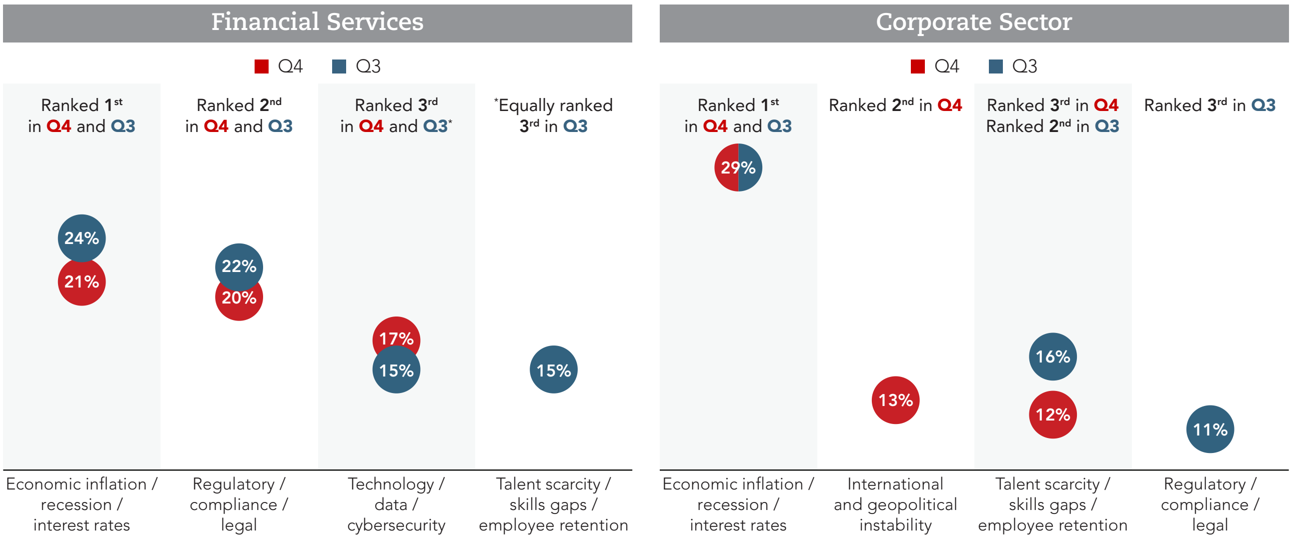
Some ACCA members attested to the progress that the Australian Prudential Regulation Authority (APRA) has made since releasing the Final Report of the Prudential Inquiry into the Commonwealth Bank of Australia (CBA) scandal (APRA 2018). One ACCA member who has moved from Sydney to a bank in the Kingdom of Saudi Arabia (KSA) called it Australia's *'burning [risk culture] platform'.* APRA recently introduced the Financial Accountability Regime (FAR) which, similarly to the UK's Senior Managers and Certification Regime (SM&CR) (FCA 2015/2023), imposes a strengthened responsibility and accountability framework on entities in the banking, insurance and superannuation industries and their directors and senior executives, replacing its Banking Executive Accountability Regime (BEAR), set up in 2018 (APRA 2023). APRA is also refreshing its risk management standards, including more detail on the board's duty to set and steer the risk culture of the institution: *'although we are principles-based, we will be clear on our expectations and what we want to see around risk culture,'* an APRA source told ACCA.

Additionally, the Hong Kong Monetary Authority (HKMA) discussed its 'no one-size-fits-all' approach with ACCA and how it expects authorised institutions in Hong Kong to adopt a holistic framework for fostering a strong risk culture. (HKMA 2020). *'We encourage banks to elaborate through self-assessments, but we also communicate with them via other channels. Culture is not an isolated topic, so because of our holistic view we incorporate the risk culture dialogue into many discussions',* said Horus Leung, senior manager, Banking Conduct Department at the HKMA.

Regarding international standards, the Basel Committee's revised Core Principles for effective banking supervision, currently under public consultation, include adjustments to the core principles on corporate governance and risk management (BCBS 2023b). The Netherlands' DNB, which employs organisational psychologists to evaluate behavioural drivers and risk culture in financial institutions, has been calling for more consistent regulation. Speaking in early June 2023, Steven Maijoor, executive director of the DNB, asserted:

'In Europe, we have implemented the Basel standards more consistently across banks of all sizes. But let's not forget that the Basel III standards have not yet been fully implemented in European regulation. And in fact, current proposals to do so contain important deviations and transitional arrangements. Arrangements that, if adopted, could lead to inadequate capital coverage of some risks for a long time. The recent stress reminds us that this is something we should really think twice about,'
Steven Maijoor, De Nederlandsche Bank (DNB)

FIGURE 3.1: Top three risk priorities of survey respondents in financial services versus non-financial corporates – **Q4** vs **Q3 2023**: *' For banks, it is still about being compliant and dealing with cyber threats'*



Source: ACCA/IMA Global Risks survey (2023)

ACTION POINTS

Risk and financial leaders are increasingly tasked with proving to clients, boards, regulators, employees, and the investing public that their firms are aware of culture as a critical risk governance concern. Further cooperation, therefore, between financial institutions and regulators will be beneficial for all, not least for consumers.

- Risk and financial professionals should collectively look at what new training, insights and incentives are needed to take advantage of structural shifts in a safe and ethical way.
- Accountancy professionals can provide vital scenario analysis of what could go wrong or what could be beneficial for stakeholders, and make sure that stakeholders are represented properly from a governance perspective. This needs to be a dynamic and inclusive process considering the pace of change in stakeholders' needs and regulatory demands.
- Banks should focus on the outcomes that rules and regulations seek to engender. In highly regulated industries, such as financial services, compliance becomes a complex affair, and as our research reveals, regulatory change remains a top risk priority for ACCA members in banking everywhere.

ACCA MEMBERS HAVE EXPRESSED THEIR DESIRE FOR CLEARER EXPECTATIONS FROM REGULATORS WHEN IT COMES TO MISCONDUCT DETECTION AND DEVELOPING BEHAVIOURAL RISK INDICATORS, WHILE SUPERVISORY BODIES SAY IT IS CHALLENGING TO REFINE REQUIREMENTS WITHOUT HINDERING INNOVATION AND ECONOMIC GROWTH.

4. The accountancy profession's perspectives

Through our member engagements, including the responses to ACCA's quarterly Global Risks Survey, we found that accountancy professionals in their various roles at banks are generally more focused on trying to turn risk management into a value-added capability – a mindset that helps their institutions meet objectives, particularly those related to the sustainability agenda. For respondents working in risk roles, we frequently heard frustration about not having the necessary buy-in and investment (ACCA 2023a; 2023b; 2023c) needed to raise risk awareness during such pivotal times.

Ethics and professional judgement are at the heart of what our profession does and, indeed, instrumental in prioritising risks and allocating resources. Accountancy professionals are trained to understand how business models work and change, how to assess risks and opportunities, and how to ensure that there are effective controls and governance, whether their organisation is public or private, so we learnt through our roundtable discussions how accountancy professionals in risk roles are doing more to address debilitating disconnects across teams and hierarchies. ACCA members discussed how participation in essential shared interests, such as KPIs, makes individuals feel safer and more involved in matters that affect everyone. As we concluded before, incorporating risk and ethical matters into workplace conversations is ***the*** secret sauce of a strong risk culture.

Today, risks are increasingly influencing and exacerbating one another, with many of our CROs and risk heads pointing to growing geopolitical complexities and how they manifest, for example, through supply chain disruptions and new sorts of ransomwares and third-party threats. Many ACCA members in the banking industry referred to the unprecedented number of national election polls across the world as their most 'underestimated risks' for 2024 in our 2023 fourth quarter Global Risks Survey. Concerns about rising fraud and cyber threats were expressed not only by international banks, but also by many respondents from community banks, credit unions and building societies. Through our open-ended questions, we discovered that political instability typically concerns financial services respondents through the 'technology, data, and cybersecurity' lens, whilst individuals working at non-financial corporates see such issues more as 'business-critical' risks, ranging from transportation disruptions to customer service and reputation risks.

Many ACCA members in risk roles admit that they are navigating territories and a landscape of multiple crises never seen before in their careers, such as changing monetary policies and inflation, as well as the socio-economic uncertainties of climate change, the latter of which has become a higher priority for all types of respondents since the end of 2022. From a risk culture standpoint, there are likely to be different pockets of opinion about global issues, as well as different national and cultural sensitivities for banks (even domestic ones), which makes it even more crucial to convene across the three lines on risk assessments and impact analysis before the damage is done or an opportunity is missed.

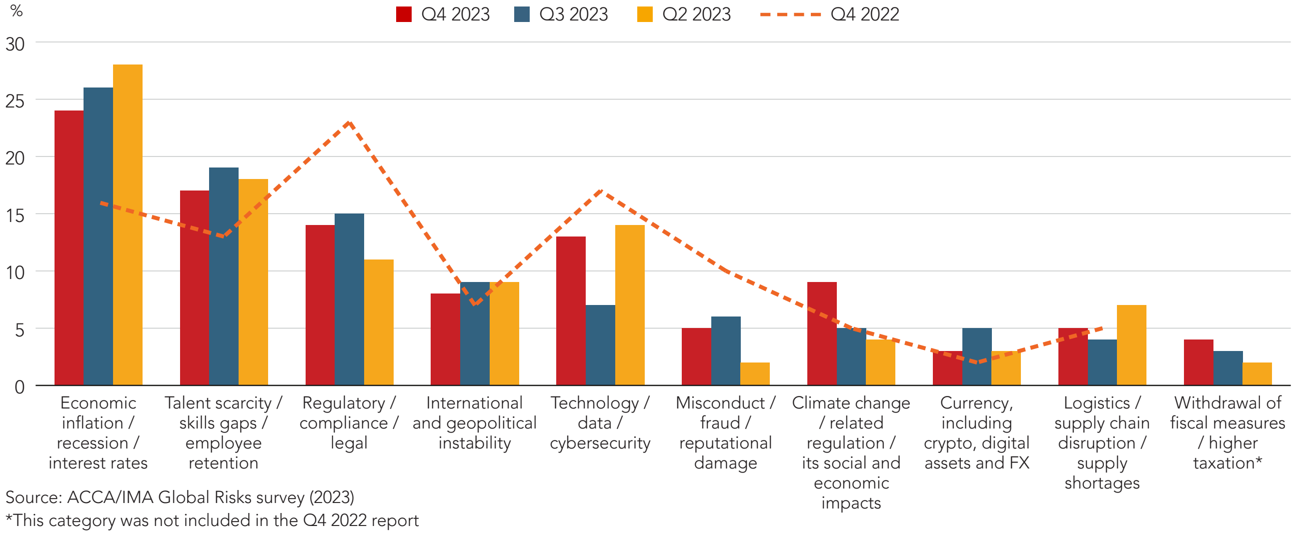
An ACCA member who is the CRO for a fast-growing fintech in the Asia Pacific, which remains unregulated by central banks in most jurisdictions, also talked about handling sub-cultures in a 'federated' manner:

> *'Being completely paper-free is fundamental to our business and sharing a common set of values is core to our existence, but from cultural and governance perspective, how we operationalise these values and deal with customer interactions varies country-to-country, especially with rapid digitalisation and diverse, constantly changing legal environments.'*
> **ACCA member, Singapore**

ACCA MEMBERS EXPLAIN HOW THEY ARE FACING AN INTERTWINED RISK LANDSCAPE NEVER SEEN BEFORE, FOR EXAMPLE, WITH INFLATIONARY AND GEOPOLITICAL IMPLICATIONS, AS WELL AS THE SOCIOECONOMIC UNCERTAINTIES OF CLIMATE CHANGE, THE LATTER HAVING BECOME A HIGHER PRIORITY FOR RESPONDENTS IN FINANCIAL SERVICES SINCE 2022.

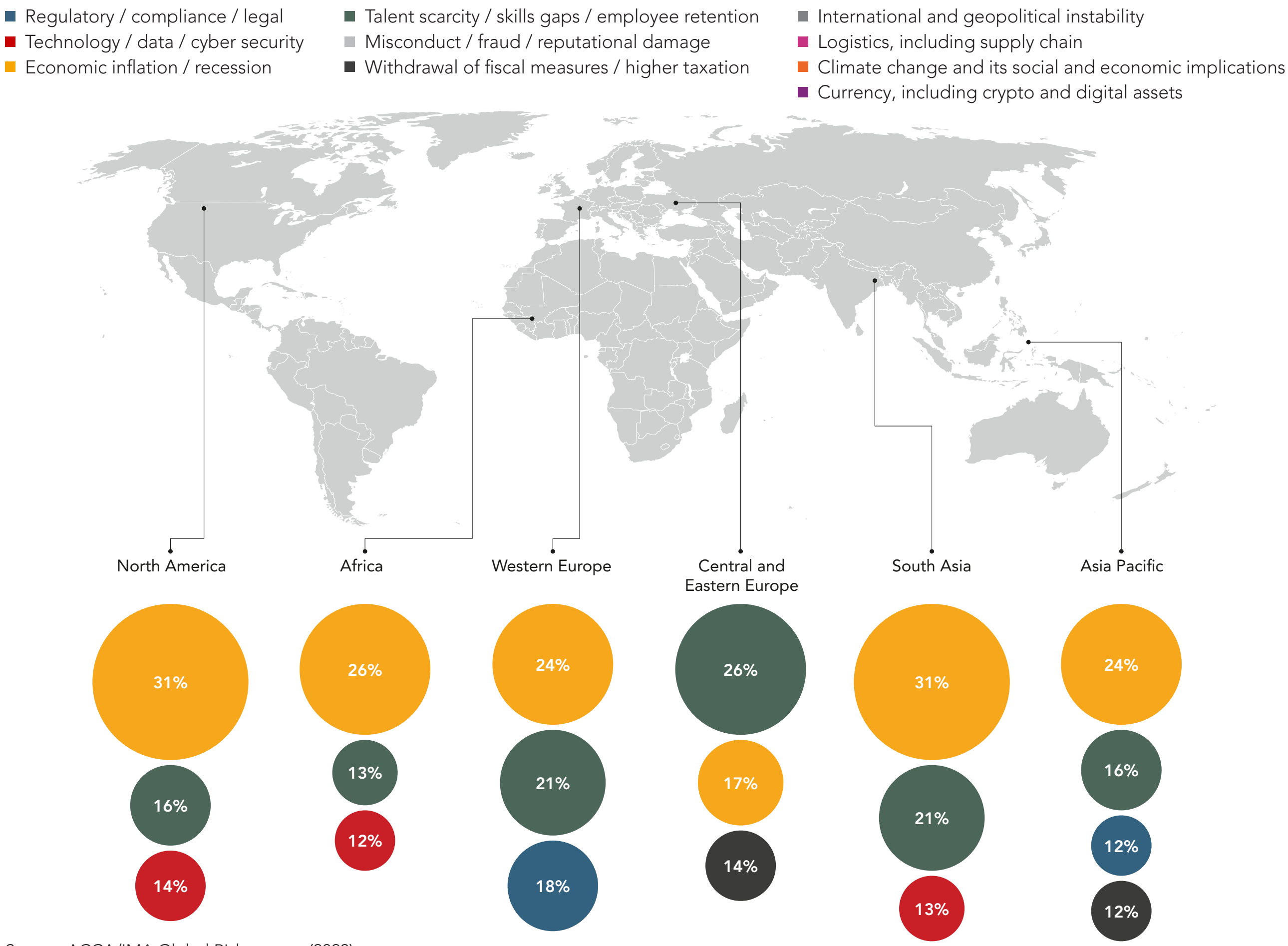
Accountancy professionals' top risk priorities for 2024

FIGURE 4.1: Top three risk priorities – **Q4, Q3** and **Q2 2023** vs **Q4 2022** – depicts the fast-changing and interconnected risk landscape



Source: ACCA/IMA Global Risks survey (2023)
*This category was not included in the Q4 2022 report

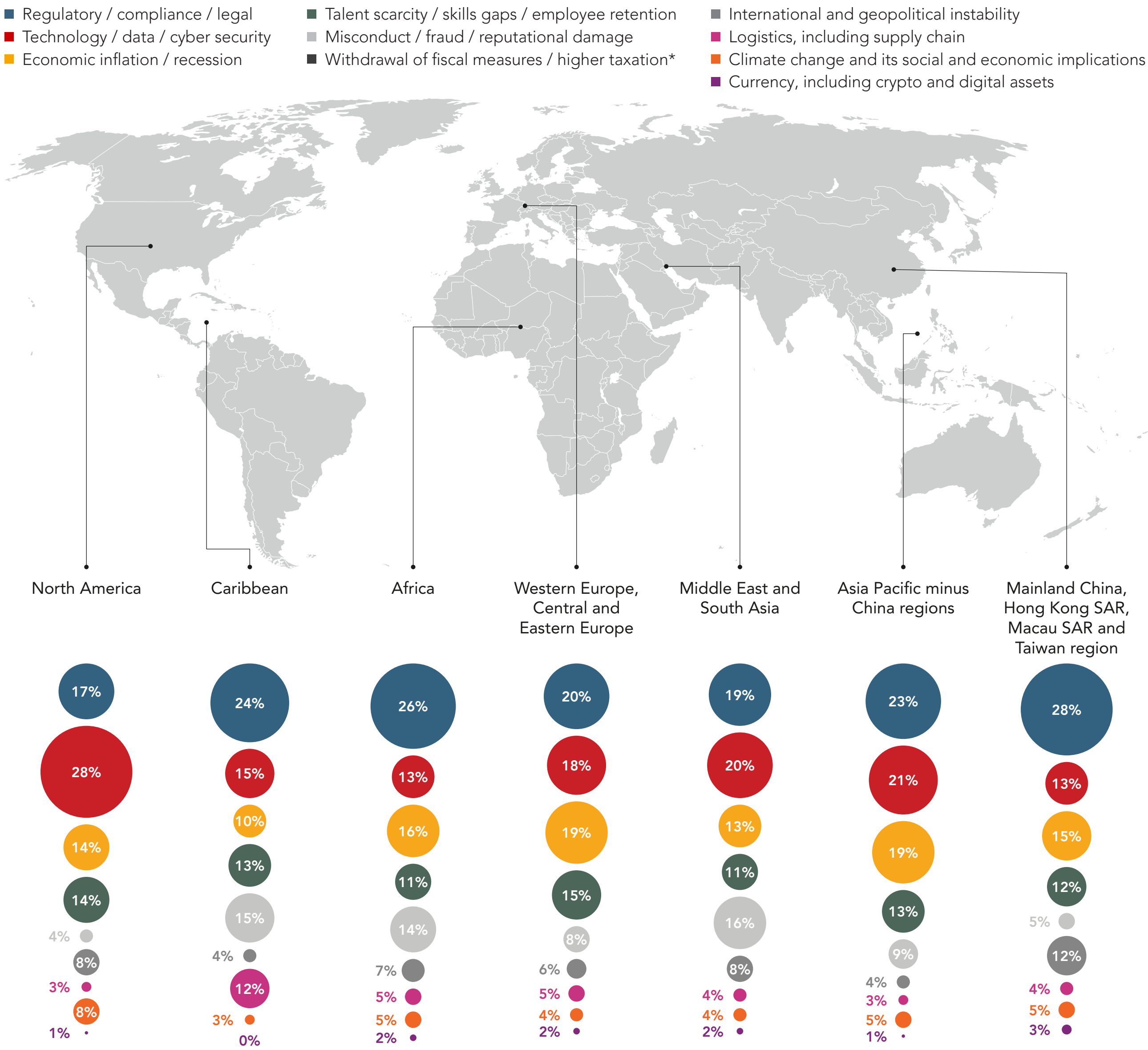
CHART 4.2a: Top three risk priorities around the world – **Q4 2023**



Source: ACCA/IMA Global Risks survey (2023)

Compare this chart with the 'Top risk priorities around the world (Q4 2022)' Figure 2.3 in Risk Culture: Building Resilience and Seizing Opportunities (2023), with Chart 17 'The top 3 risk priorities around the world, Q2 2023', in Global Economic Conditions Survey: Q2 2023, and with Chart 19 'The top 3 risk priorities around the world, Q3 2023' in Global Economic Conditions Survey: Q3 2023.

CHART 4.2b: Top three risk priorities around the world – **Q4 2022**



('Don't knows' remain the balancing figure for each region)
*This category was not included in the Q4 2022 report

'Economic inflation, recession, interest rates' remains a top risk priority for all ACCA members across sectors and regions, but our surveys also have shown how 'regulatory change, legal and compliance' continues to be a greater concern for those in financial services compared with members working at non-financial corporates. Another striking trend is how 'talent scarcity, skills, and employee retention' climbed into the top three since our original survey in late 2022. Talent retention has been mentioned more each quarter as an 'underestimated risk' by respondents in both financial services and non-financial corporates, and we see competition for top talent heating up with some ACCA members leaving banking to take on 'more entrepreneurial' roles at tech firms, for example, Amazon and Meta.

ACCA members working in banking worldwide noted an increasing demand for governance, risk and compliance staff, especially in the Middle East and Asia Pacific regions, which overall have seen their economies benefit from international trade transformations and new trade agreements. We also found that banks are facing greater reputational challenges when it comes to environmental and social matters given, they are relatively behind other industries in meeting net-zero transition targets and may not be considered as ESG-friendly by those who come with the best experience or most sought after skills. See ACCA's reports: *Green finance skills: the guide* (Skelton 2023) and *Ethical dilemmas in an era of sustainability reporting* (Machado, Saw, Chow 2023).

Several ACCA members at banks also mentioned the challenges with lengthy regulatory remediation programmes and how these processes can depress morale and dampen innovation. This was yet another area where the interconnectedness of risk means ACCA members in risk roles continue to find new ways of coordinating with other functions, such as HR and IT. *'If the regulators do not come up with a reasonable measurement of what makes a so-called good risk culture, and just punish us for every insignificant breach, when there is no major impact to the organisation, then it's going to be even more difficult to educate staff [eg anti-fraud training] and persuade people to stay in the financial industry. I think all the regulators must come together and decide how they want us to stimulate conduct and culture instead of penalising us for petty non-compliances,'* a head of compliance member at a bank in the Asia Pacific said.

Rising interest in behaviour patterns and confirmation biases

Risks have become so widespread that many ACCA members from banks use the words 'threats' or 'hazards' instead, and say it makes sense to focus on the behaviours behind the risks because behaviour is something you can measure, monitor, and strengthen. '*There are elements of behaviour that you can observe whereas the concept of culture, is like what is it?'* explained one respondent.

A chief risk officer (CRO) from a bank in Ireland commented: *'We have had much success recently with incorporating behavioural economics and when I engage the business in risk assessment exercises, I don't even mention risk anymore. Risk is counterintuitive because the responses range from blank looks to "it's fine" to panic or a tendency to equate risk with an assumed outcome.'*

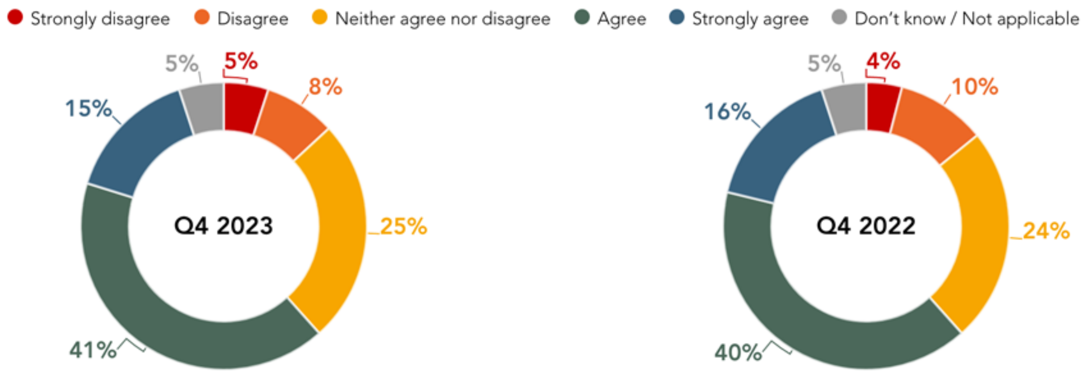
Although the bank collapses in 2023 prompted more interest in conduct metrics than had been the case initially following the GFC, survey respondents overall still seem uncertain about whether the risk culture at their organisation is effective at fostering behaviours that are in line with stated values. Through the banking roundtables and interviews, we also found more of the inside story of the misalignment between what is said and what is being done.

RISKS HAVE BECOME SO WIDESPREAD THAT MANY ACCA MEMBERS FROM BANKS USE THE WORDS 'THREATS' OR 'HAZARDS' INSTEAD, AND SAY IT MAKES SENSE TO FOCUS ON THE BEHAVIOURS BEHIND THE RISKS BECAUSE BEHAVIOUR IS SOMETHING YOU CAN MEASURE, MONITOR, AND STRENGTHEN.

Members talk about how policy updates do not guarantee behaviour change because people look at the behaviour norms of the organisational culture and naturally think that is how to act. And, when it comes to raising awareness of fraud and cyber risks, members from banks attest there often seems to be more stick than carrot. We also sensed some concern about window dressing in the behavioural risk management discussions. *'I have spent over 15 years in ethics and compliance and will say that policies are more like reference documents. I have seen and continue to see much misalignment about what is on paper versus what is in practice, and I have never come across a board that gets this,'* another member in Europe shared.

Those survey respondents who were confident that their organisation will detect unexpected behavioural or misconduct issues were also more likely to have said that their organisation had conducted a risk maturity assessment or audit of its risk culture. For most ACCA members at banks, it is now about how their firms go from talking about behaviours to developing a concrete way of measuring them and using that information strategically to make the changes needed to address the behaviours behind the risks. We find that banks are looking at this from various angles and starting points.

FIGURE 4.3: Post-pandemic environment is increasingly challenging, with scarce resources, rising costs and need to put new technologies into practice – **Q4 2023 vs Q4 2022**



Source: ACCA/IMA Global Risks survey (2023)

'There is always going to be an element of bias with leaders thinking behaviour [in their workplace] is exemplary and risks minimal. As risk and accounting professionals, our antennas should immediately pop up when we see a behavioural issue and what it might give rise to, but we must always look for data when trying to understand or pin a risk to a behaviour, and always ask what risk does this data appear to indicate. Make sure to read or review the data in detail and reach out and have those challenging conversations with your business partners and team leaders,' said another ACCA member in Europe who is the CRO of an international financial services firm.

We also have found that one of the strongest influences of staff behaviour at banks is the immediate line manager. *'I am the one in our capital markets group who is in charge of monitoring risk, and I am not talking about only financial issues, I mean our processes and our people, and the many interdependencies. For example, we have been working through the Libor change versus also acquiring a new bank, and if we are going to understand the interconnectedness between these activities and how our [risk] framework is tested, then we as a team need to talk about both the positives and the negatives of risk,'* a member from a bank in Canada said.

FIGURE 4.4: Behavioural risk deep dive

Source: Dr Mirea Raaijmakers

ACTION POINTS

As banks work on prioritising risks better, including how to identify behavioural patterns that make up the root cause of risks, financial or non-financial, we found that accountancy professionals can develop more structure for gathering insights that help senior management understand and promote positive aspects of behaviour.

- It is not so much about what policies require of people. It is about finding out what is happening in practice across operations, ie what is driving behaviours. Then you can zoom in on how certain behaviours lead to specific outcomes and establish what habits need to be broken and, indeed, what 'carrots' need embedded.
- Consider how you can take advantage of technological advancements to gain useful insights more efficiently and accurately. It also is important to link the information in your assessments to the different levels of maturity, as spelled out in 'Risk Culture: Building Resilience and Seizing Opportunities' (Johnson 2023). Incentives and rewards can tell you if you are on the right track.
- Banks need a better way of representing culture and leadership – a way that enables a richer and more accurate view of what is happening up and down the firm. Accountancy professionals should look beyond the numbers to help tell that story and promote a culture of roundtable engagement where people from different roles and levels convene to exchange ideas and feel free to speak up about risks.

ACCOUNTANCY PROFESSIONALS SHOULD LOOK BEYOND THE NUMBERS TO HELP TELL THAT STORY AND PROMOTE A CULTURE OF ROUNDTABLE ENGAGEMENT WHERE PEOPLE FROM DIFFERENT ROLES AND LEVELS CONVENE TO EXCHANGE IDEAS AND FEEL FREE TO SPEAK UP ABOUT RISKS.

5. Lifting the clouded view of behaviour

The events of early 2023 showed us once again that behavioural risks can be existential threats to firms, resulting from decisions made or left unmade within an organisation, and through the reactions of stakeholders as news of trouble spreads.

Despite the severe consequences, investment in internal behavioural expertise remains relatively rare. Although a number of banks have created teams (for example, ING, ABN Amro and NatWest), these are the exception rather than the norm and are located within disparate areas of their firms with differing roles and mandates (Wood 2021). This mismatch between inherent behavioural risk and the resources and capabilities devoted to it demands further analysis. There needs to be an understanding of the key factors that prevent managers from investigating with curiosity and acknowledging and acting on these risks. Perhaps the further up the mountain you go, the more the view is obstructed by clouds.

> THERE NEEDS TO BE AN UNDERSTANDING OF THE KEY FACTORS THAT PREVENT MANAGERS FROM INVESTIGATING WITH CURIOSITY AND ACKNOWLEDGING AND ACTING ON THESE RISKS. PERHAPS THE FURTHER UP THE MOUNTAIN YOU GO, THE MORE THE VIEW IS OBSTRUCTED BY CLOUDS.

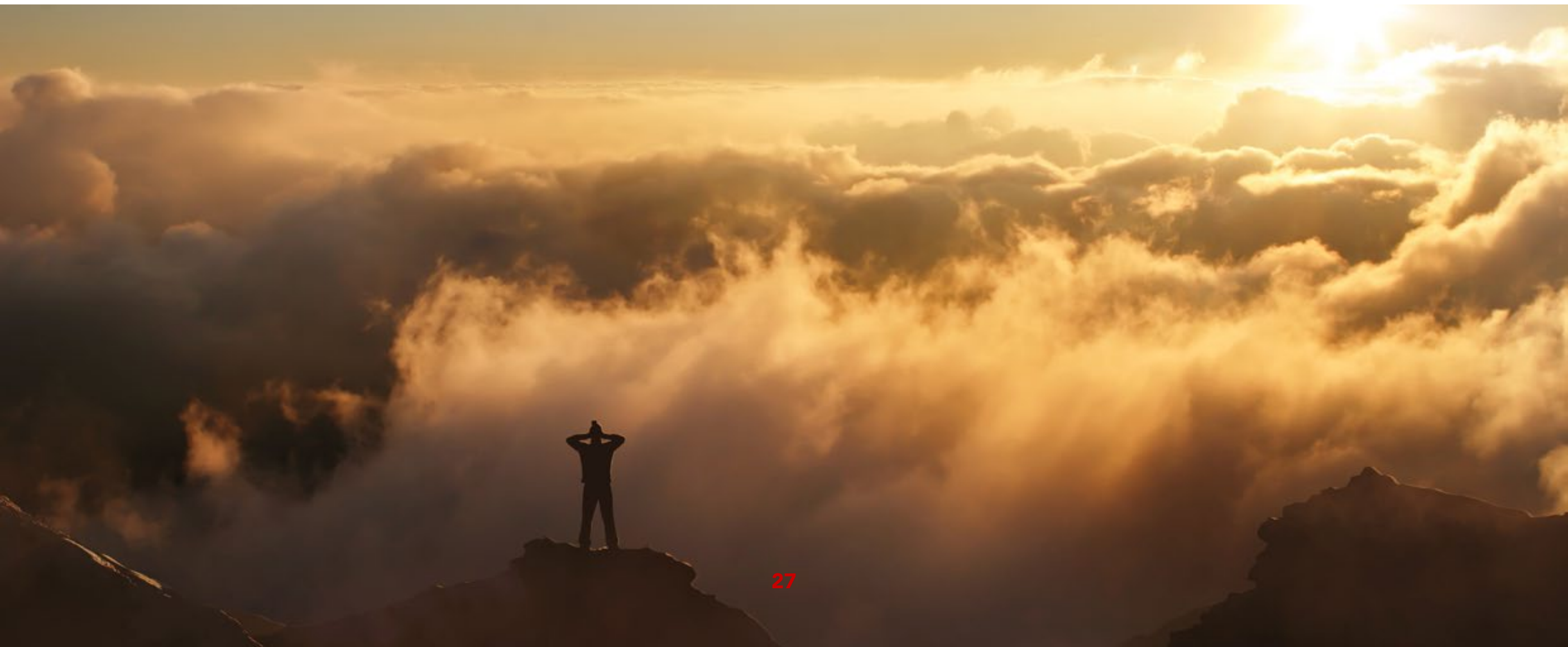
Why does the understanding of behaviours become clouded?

1. Overconfidence

Daniel Kahneman tagged overconfidence as the most significant of the cognitive biases to which we are all subject, and the one he would seek to eliminate if he had a magic wand (Shariatmadari 2015). It is both one of the biggest and most prevalent weaknesses to which human judgement is vulnerable; and acts as an exacerbator of other decision-making biases.

Nonetheless, most senior management staff in financial firms recognise that they cannot be experts in all areas of their organisations, whether cyber risk, complex derivative valuation or the rapid development of AI. They and their boards and regulators acknowledge the limits of their own understanding in these areas and demand investment and know-how.

It is imperative that managers are equally realistic about their lack of understanding of the complexity of behaviour, culture and psychology, to protect themselves and their firms from the errors to which human nature makes everyone prone. There is a need to temper overconfidence in the belief that one is not overconfident!



2. Creating patterns when there are none

It is natural for humans to want to believe that things are under their control and explainable, and the desire to control our surroundings and situation is ingrained in our consciousness. Hence, when people sense that they have little control or understanding they will see patterns and structure where none exist and thereby create a spurious but reassuring sense of order (Koehler 2023).

For management, this can lead to an over-simplification of cause and effect and to comparing situations that are not analogous. Different systems and contexts may be simple, complex or chaotic, with varying implications and requiring different approaches. A jet engine or a piece of banking technology may well be complicated, but the outcomes should be predictable. The interplay of human behaviour across teams, firms, locations and industries is not comparable, as these are less predictable systems, with feedback loops, emergent and adaptive behaviour. Furthermore, as with the wobbling Millennium Bridge in London, unintentional patterns in crowd dynamics can lead to unexpected outcomes (SRC 2021).

For a manager, this means embracing an uncertain and experimental world where there will be failures as well as successes and being able to justify and explain these. It requires thinking about the organisation as an evolving complex network, not as static lines on a chart.

3. The barrel not the apple

The environment and teams in which people operate have a significant impact on their behaviour. Importantly, humans are social creatures who are heavily influenced by the actions, opinions and norms of those around them, with a strong desire to fit in. The importance of this local context is further fuelled by factors such as resource levels, complexity of processes, bureaucracy, perceptions of fairness and psychological safety.

A common response to issues and incidents within many organisations, when they involve misconduct, is to attribute blame to an individual (the apple) rather than seeking to understand the role of the wider environment (the barrel).

For management, there can be a strong incentive to point the finger at individuals and to categorise issues as unfortunate one-offs and exceptions, which can be neatly resolved through the sanction or exit of staff. Adopting a more behaviourally informed approach to understanding culture requires acknowledging the key role of the environment in driving behaviour and accepting deeper systemic root causes; for managers this means adopting an approach that reinforces their own responsibility and places their own attitudes under the spotlight too.

By **David Grosse**
Founder, Behavor Ltd and Managing Director – UK, Swarm Dynamics

ACTION POINTS

An informed understanding of risk culture and it's behavioural root causes requires banks, regulators, boards and executive management to recognise and tackle biases, beliefs and systemic barriers that impede progress. In particular, to temper over confidence in their grasp of culture and the drivers of behaviour, to resist the lure of linear solutions to complex problems, and to acknowledge the importance of the wider organisational environment on human behaviour rather than attributing blame to an individual, companies should:

- Ensure appropriately skilled and experienced resources are used to assess risk culture, to get beneath surface level assumptions and understand the drivers of behaviour
- Assess the promise of new culture analysis tools and approaches that are being driven by developments in AI and the exponential growth of data. Investors, regulators, ratings agencies and others are already using behavioural insights derived from externally available big data, and similar internal efforts within organisations may help them understand the landscape, identify outliers and track change.

6. Uncovering leadership blind spots

We could not overlook the leadership risk perspective and how this influences the definitions, decisions, approaches and reactions to a bank's risk culture.

Several participants in our banking roundtables also brought up the notion of how the risk dispositions of their leaders may affect performance, and we found a growing body of literature on this subject given the amount of accessible external data about banks and the backgrounds of their executives. One that stands out is a King's College London paper, *'The Wolves of Wall Street? Managerial Attributes and Bank Risk'*, which concludes that the business decisions adopted by bankers can be predicted by their personal risk attributes, or what the authors call it, their 'X factor' (Hagendorff et al. 2021).

The paper explains how the risk personalities of the top five most senior executives of banks can predict the nature of the business model; how senior management's personal characteristics, or risk fingerprints, influence the banks' corporate performance. The take home message from this was that observable behaviours have a significant impact on outcomes, and that their fingerprints remain consistent over time.

This aligns well with the 'risk type compass test' developed by Geoff Trickey, the founder of UK-based Psychological Consultancy, which advocates that personalities are shaped at a young age and don't deviate much over the years. Speaking to ACCA's 'CROs and Heads of Risk Forum' he said:

> *'We are talking about subjective risk – the ways in which we instinctively respond to risk and uncertainty – and how these play a very significant part of the decisions people make.'*
> **Geoff Trickey, Psychological Consultancy**

Grounding the overconfidence

ACCA members who work at banks also referred to 'red teaming', a strategy that brings together different perspectives to plan and resolve. We found that this has been applied at the board and C-Suite levels more often in recent years across sectors, given the complex situations companies have been facing with the pandemic and other disruptions. In one case, there were voices who wanted more thought to be given to decisions rather than simply focusing on the dominant view of being cautious. It was right after the first lockdown, when tough decisions had to be made but that it was essential to be cautious in a creative way rather than simply being cautious by taking no action.

We heard about other cases where red teaming helped ground the typical overconfidence of boards and top executives by spurring spirited debates. Vera Cherepanova, founding partner of Studio Etica and member of ACCA's 'Global Forum for Governance, Risk and Performance', said:

> *'You bring together various and diverse individuals. They can be formed internally or externally, but their objective is to provide fresh perspectives, challenge assumptions and identify blind spots that leaders might overlook otherwise. You emulate adversarial scenarios to stress test your plans. This process reveals vulnerabilities and enables leaders to refine their strategies.'*
> **Vera Cherepanova, culture and ethics advisor**

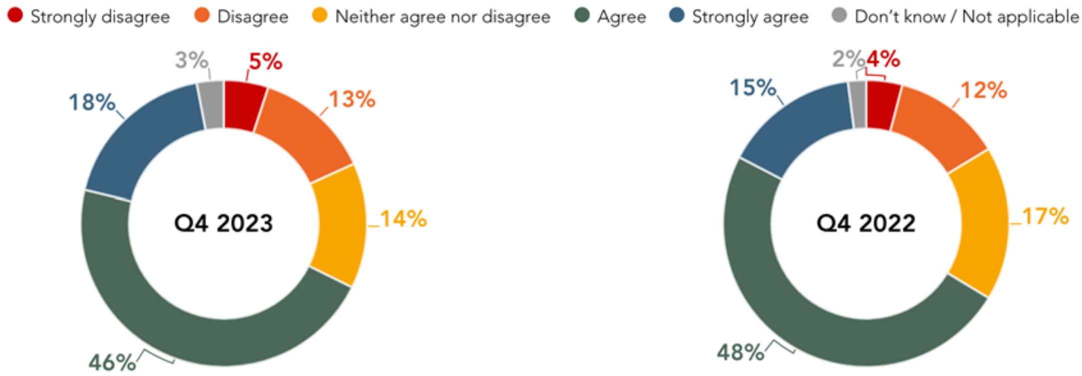
Our forum and roundtable discussions got us talking about middle managers and those who do more to understand how different people on their team deal with risk are better at capitalising on the various individual strengths of each member. Michele Wucker, author of *'The Gray Rhino: How to Recognise and Act on the Obvious Dangers We Ignore'* and *'You Are What You Risk: The New Art and Science of Navigating an Uncertain World'* (Wucker 2016 and 2021), delved into this during ACCA's 'CROs and Heads of Risk Forum's' session in November 2023, she said:

> *'A story that Geoff [Trickey] told me once was when he worked with a team at a bank. One woman was disappointed because she wanted to be an adventurous, carefree risk type, but in the end came across as prudent. At first, she considered this boring, but it was around the time that GDPR came out and the group realised that she was the only one who was methodical enough to pay attention to different risks around that.'*
> **Michele Wucker, *Gray Rhino* author**

The point is that strong leadership involves an appreciation of perspectives that challenge and complement each other in a way that creates value and sustainable investment returns. 'It is not just about accepting, but also welcoming different perspectives. You benefit from the different options, risk appetites and therefore a more contextualised understanding of a situation that enables a leader to guide or make a decision that will deliver the right outcomes, including long-term financial returns,' said Patrick Butler, a former investment banker, chief operating officer and head of compliance, now a business transformation consultant, innovation venture founder, investor and board member, and key member of ACCA's special interest group on risk culture. See Butler's bank leadership lessons in the appendix.

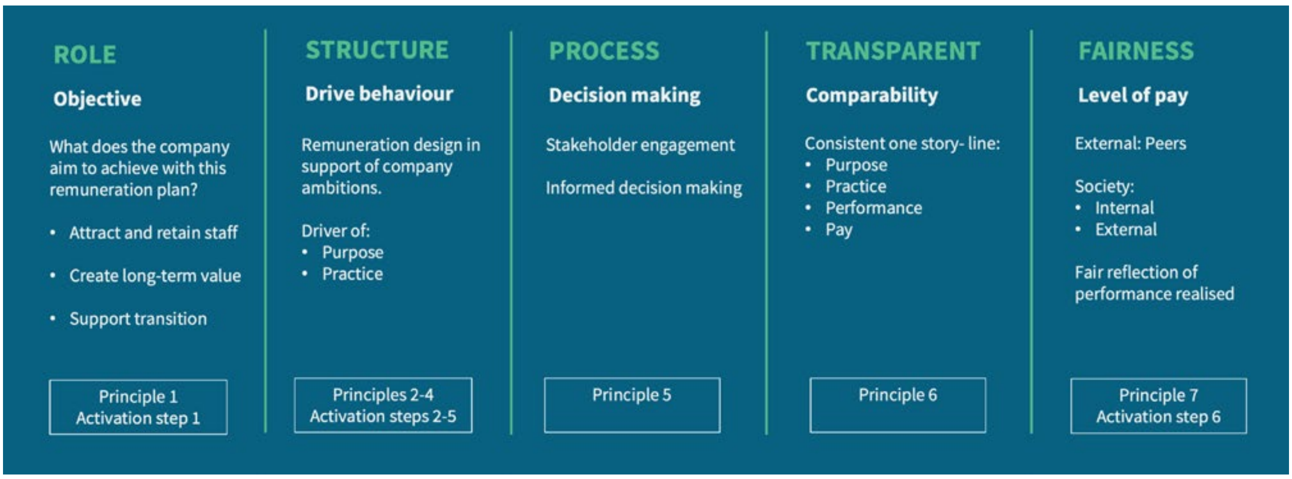
'IT IS NOT JUST ABOUT ACCEPTING, BUT ALSO WELCOMING DIFFERENT PERSPECTIVES. YOU BENEFIT FROM THE DIFFERENT OPTIONS, RISK APPETITES AND THEREFORE A MORE CONTEXTUALISED UNDERSTANDING OF A SITUATION THAT ENABLES A LEADER TO GUIDE OR MAKE A DECISION THAT WILL DELIVER THE RIGHT OUTCOMES, INCLUDING LONG-TERM FINANCIAL RETURNS.'
PATRICK BUTLER, CALITOR CONSULTING

FIGURE 6.1: Risk remains in a vacuum at the top and needs to be integrated on all levels – **Q4 2023 vs Q4 2022**
(Senior management is sufficiently aware of what is going on at all levels)



Source: ACCA/IMA Global Risks survey (2023)

FIGURE 6.2: What is responsible renumeration?



Source: Reward Value

ACTION POINTS

Understanding how different team leaders across the organisation think about risk – for example, what is acceptable and what is not – helps major decision makers influence the organisational behavioural change needed to achieve goals and turn the dial in the right direction. Through our member engagement, we found shadow boards, employee task force groups and mid-level committees to make profound differences.

- In setting up the appropriate risk governance processes, risk and financial leaders should think about the human beings they are trying to influence and how their example-setting affects them. It is easy to blame people for how they behave but speaking up is a behaviour that organisations can encourage.
- Management By Wandering About (MBWA) is challenging in today's virtual world, but accountancy professionals can network across functions; breaking down silos and fears while also fostering familiarity, trust and collaboration through asking questions and getting everyone involved in the conversations.
- People will only change their behaviour if they see rewards and outcomes they identify with, so it is important to connect personal ambitions with desired behaviours and stated values of an organisation. The cause and effect must be obvious and compelling through governance, risk and performance frameworks, and the rewards must be aligned with longer-term incentive programmes. See appendix on key questions for designing responsible renumeration.

PEOPLE WILL ONLY CHANGE THEIR BEHAVIOUR IF THEY SEE REWARDS AND OUTCOMES THEY IDENTIFY WITH, SO IT IS IMPORTANT TO CONNECT PERSONAL AMBITIONS WITH DESIRED BEHAVIOURS AND STATED VALUES OF AN ORGANISATION.

7. AI's paradigm shift

It was difficult to have any discussion for this report without talking about how AI is transforming banking, not least in regard to risk management and the incredible insights that AI tools provide.

While AI in reference to software, statistics and data analysis has been used by banks for decades, as with behavioural science, we found varying maturity levels in understanding the incremental impacts. ACCA members at banks – regional and global – confirmed various AI use cases for credit scoring, detecting fraud, cyber risks, financial crime and improving financial risk reporting and often referred to these applications as 'classical' AI themes. Some said they are exploring generative AI (GAI), which is a game changer since everyone in the public domain can use and access it. We learnt how GAI might enhance anti-money laundering (AML) efforts, internal risk controls, regulatory monitoring, alerts to policy changes, and other structural transformations, but also pose new risks, such as breaching IP laws which may not be visible to the user[2].

By the end of 2023, we saw examples of some banks exploring how to identify conduct risks by using unstructured data from various communications channels. Such pilots are not necessarily purely AI-driven but include advanced analytics to detect previously unsuspected behavioural issues and patterns. These advancements provide highly productive and predictive capabilities, but there are also potentially unintended consequences to consider.

AI can listen to a year's worth of voice trade tapes and tell us how traders from different geographical locations are colluding because it can learn the languages. It can detect exchanges on WhatsApp groups, whether they are making off-market trades, or using some grey space to make any kind of trade that seems opportunistic. Dr Roger Miles, a behavioural risk expert and another core member of ACCA's risk culture special interest group said:

> *'This gives us the prospect of getting on top of money laundering, off-market trading, insider dealing, grey market exploitation, which in finance has eluded us, frankly, forever.'*
> **Dr Roger Miles, behavioural risk expert**

He gave our profession some tough food for thought when he explained how the bots are moving so swiftly that they could potentially imitate the recognised human patterns of misconduct. He referred to many historical precedents for human intelligence devising 'games' to evade audit controls, for example, Volkswagen's emission test software (FMSB 2018).

We heard about both existing and new use cases at banks, and found that while many of them around the world are analysing practical potentials of GAI, most of the ACCA members working in banking that we spoke to said they have not [as of end of 2023] identified or clearly defined a GAI use case yet. In the near term, different use cases and new technologies to support them, such as chatbots, are emerging fast and, from what we see, banks appear to be configuring various versions of their own in-house. Their value will lie in true integration into business processes, and ACCA members stress it will take time for the risk and compliance community to work out how to ensure these technologies operate as expected.

Getting governance up to speed

Bigger banks say that the real challenges stem from the way unstructured data is currently stored within organisations. ACCA members also say there are many unanswered questions about the ability to integrate greater levels of precision into business processes and how potential use cases withstand the discipline and rigour of the three lines (of defence). This is another major challenge that the accountancy profession can help the industry tackle.

Furthermore, there are numerous ethical issues that any organisation needs to be sure about when it comes to anonymising and training the data. One of them is identifying the right outliers based on where the data is sourced from. For example, are there personally identifiable data points that will be shared? Is the data covering diverse populations? 'In banking, we are all trying to use AI as much as possible and have huge sources of

2 The *Evident AI Outcomes Report*, published by London-based firm Evident Insights (2023a), provides a most comprehensive view of what is happening in the global banking community as the AI race accelerates. The 'Evident AI Index' compares the AI capabilities of major banks based on surveyed and external data, creating a global benchmark of AI maturity for the banking industry (Evident Insights 2023b) with categories including transparency, talent, innovation, leadership, public communications and patents, all in relation to AI strategy. It also provides an extensive list of KPIs that banks can use to assess their progress against the five capability areas explored in the January 2023 report. See appendix.

'IN BANKING, WE ARE ALL TRYING TO USE AI AS MUCH AS POSSIBLE AND HAVE HUGE SOURCES OF DATA THAT WE USE, BUT ONE OF THE KEY PIECES THAT WE NEED TO THINK ABOUT IS CLEANSING THE DATA SO THAT THE TRAINING DATA IS INDICATIVE OF REAL-WORLD SCENARIOS, AND THIS IS VERY DIFFICULT TO DO.'
ACCA BANK MEMBER IN THE UK

data that we use, but one of the key pieces that we need to think about is cleansing the data so that the training data is indicative of real-world scenarios, and this is very difficult to do', another ACCA bank member in the UK explained.

ACCA members emphasised the importance of considering the scenarios of both existing and new use cases together because irrespective of whether the objective is credit card fraud prevention, retail customer experience or something else, it is crucial to comprehend simultaneously both the desired outcomes and unintended consequences and make them transparent to stakeholders and shareholders.

We also found how accountancy professionals can strike the balance between what the numerical data tells us versus what is happening in practice, which is invaluable for informing decisions and maintaining trust during such rapid disruption. Amid all the clamour, we see banks setting up task forces, comprised of security architects and other colleagues across functions and hierarchies to prioritise resources and KPIs effectively. We heard how these inclusive groups are more effective than setting up a dedicated board committee. Some members talked about how they are working with policy makers too. For example, ACCA members at regional banks in the US told us about how state governments have been creating their own laws (Government Technology 2023).

'The chatbots and how they manifest will be interesting because weird things can happen. What if your chatbot says something racist to someone or what if your chat bot gives you wrong advice because chatbots are more innate and that could be scary once you get to specific tasks?,' said a CRO from a regional bank in the US. He added:

> *'The potential impacts of the large language models must start with the board, but I'm not sure there's a new governance spin on it. I don't think you need a new board committee, for example, because the questions will still be for the board. For example, could this chatbot save us US$20m a year by closing our call centre in the Philippines? These are big strategic cost decisions for boards to decide.'*
> **CRO from a regional bank in the US**

ACCA members say that even when analysing and planning a single use case – for example, for complaint letter generation – numerous questions emerge and require varied viewpoints from legal to human resources. The consensus is that you cannot take away the human thinking element and we did not come across any ACCA members at banks who said their institution had entirely replaced a policy or management procedure with AI and machines.

While banks are obviously keen to discover ways they can use AI to better identify and summarise risks at a high level, it also would be unwarranted at this stage to say that an AI model could understand an organisation's risk appetite, or conclude what is safe and ethical. That also brings us back to compliance issues, considering how adopting these technologies requires more understanding of how the subject matter works and how to define it correctly. At present, if faced with an emerging risk, allowing policies to be updated automatically with no humans involved could be catastrophic.

Cooperation across industry

If risk and financial leaders as a collective community truly embrace the idea that we must learn and understand the implications of AI tools, including how they take on more physical tasks, the value that they bring to their organisations will be massive. Without that, organisations will struggle to reap the benefits and reduce the risks that we all potentially face. Studies are also beginning to show that, from a productivity standpoint, those individuals who use AI as part of their personal way of working with their teams can produce significant value, especially as business models rapidly evolve. Banks are not only competing with each other, but with payment systems, tech companies, e-commerce and retailers to name a few, with many companies crossing over into multiple sectors.

One ACCA member, who is head of enterprise risk management at a bank in the Middle East, explained:

> *'Boards need to be thinking about how they are going to tackle innovative forces and how these affect their existence – what talent will be wiped out over the next few years and what talent will be needed. We have some serious decision making taking place in our industry right now.'*
> **ACCA member, Middle East**

Starling's Stephen Scott, who presented to ACCA's 'CROs and Heads of Risk Forum' in March 2023, has been advocating that no one bank or regulator can do this alone. He stressed:

> *'Regulators might not have the resources, but they have to be in the room. Firms that are expected to put things into practice effectively clearly have a voice that needs to be heard. Technologists have ideas on how they can make the world a better place and similarly academics, who tend to speak only to one another about each other's papers, are doing important work that has real practical application, so they should be in the room as well.'*
>
> **Stephen Scott, Starling**

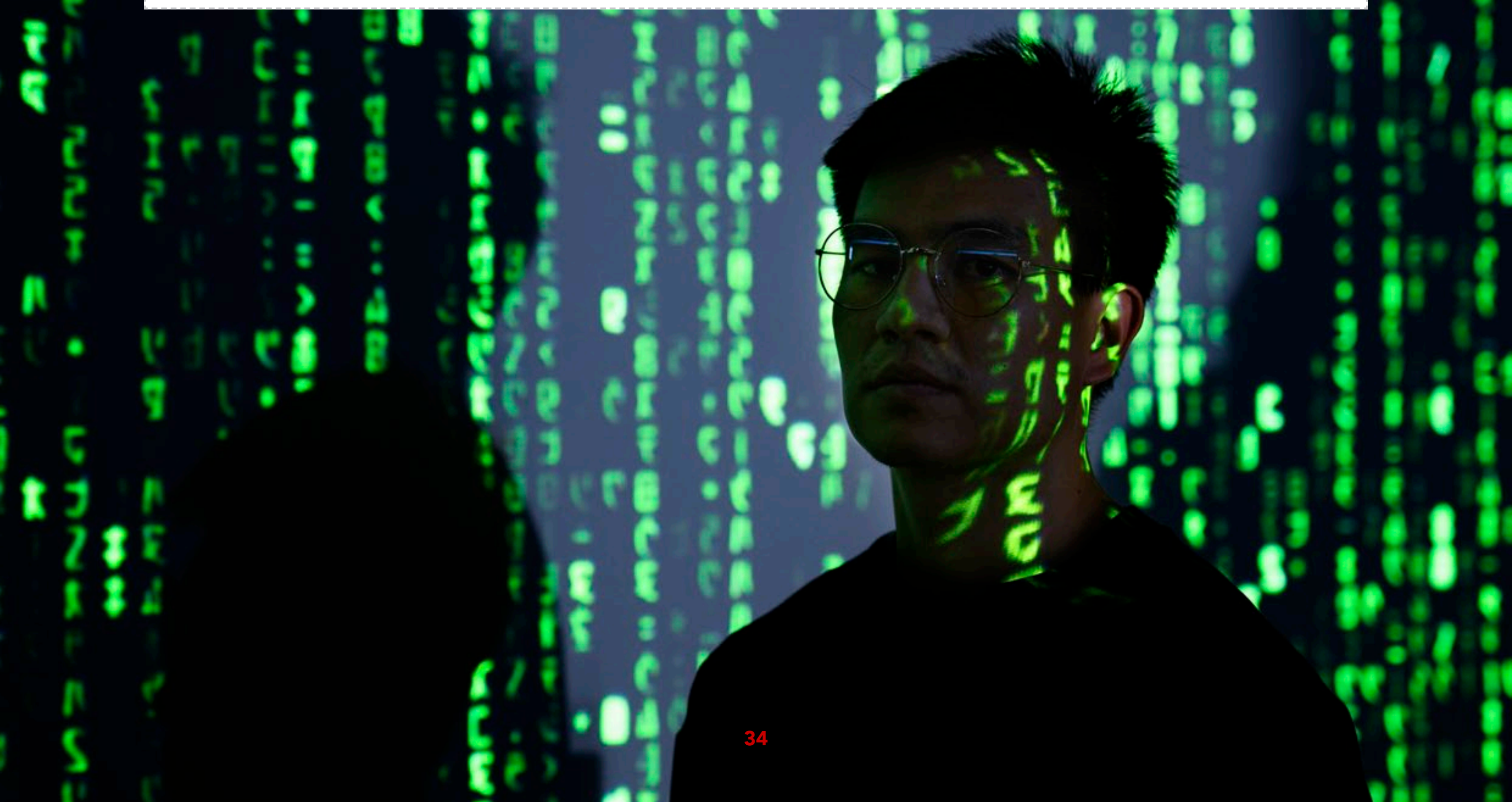
At the Good Governance Academy's 10th Colloquium on *'The Risks and Opportunities of Generative AI'* held virtually in association with ACCA in November 2023, Dr Miles warned of an AI-generated disaster by the end of 2025:

> *'The history of regulation, the history of risk controls and audits of all these things is a history of catastrophe followed by regulatory catch up. As one of the advisers to the government programme we have in the UK on the future governance of AI, what worries me is that most of the representation in the think tank is from the developers rather than those concerned with cognitive and social harms.'*
>
> **Dr Roger Miles, behavioural risk expert**

ACTION POINTS

Risk and financial professionals at banks must come together to devise a strategy for tackling the issues that the AI paradigm shift poses. As there are different types of financial services firms, including hedge funds and fintechs which have little or no regulation (and are unlikely to ask to be regulated), one hurdle will be how to solicit their participation because they also matter when considering potential systemic risks. The public trust component is significant for all.

- Accountancy professionals, particularly those in the audit industry, should develop a powerful response to what Dr Roger Miles refers to as 'this blockbusting cognitive challenge'.
- Risk and compliance experts must swiftly learn how to collaborate and analyse the implications for customers and other stakeholders because if AI gets one thing wrong, it can lead to problems on many levels.
- Accountancy professionals in all their roles have a shared duty to ensure that AI is used safely and everyone in our profession plays a part. See how ACCA members around the world view the potential for digital technology for the profession as a whole in other reports, *'Digital horizons: technology, innovation and the future of accounting'* (Brisbourne 2023a) and ACCA's *'Quick guide to AI'* (Brisbourne 2023b). See also *'Building the foundations for trusted artificial intelligence'* ACCA and EY (Vaidyanathan and Koene 2023).



8. The relationship between risk and internal audit (IA) continues to evolve

How organisations enhance collaboration and decision making across the three lines of defence (3LOD), now known as the 'three lines', remains a hot topic with ACCA members across sectors and regions (IIA 2020).

Many of our current CROs or heads of risk working within financial services previously worked as the head of internal audit, and as financial firms of all types continue to undergo restructurings or 'reorgs', we hear about new titles that reflect this experimentation, frequently in expanding the second line. For example, we see more members moving into 'change management execution' roles on the second line, as well as one member at a global bank who moved from the second line to work in a new role of 'compliance stewardship' on the third line.

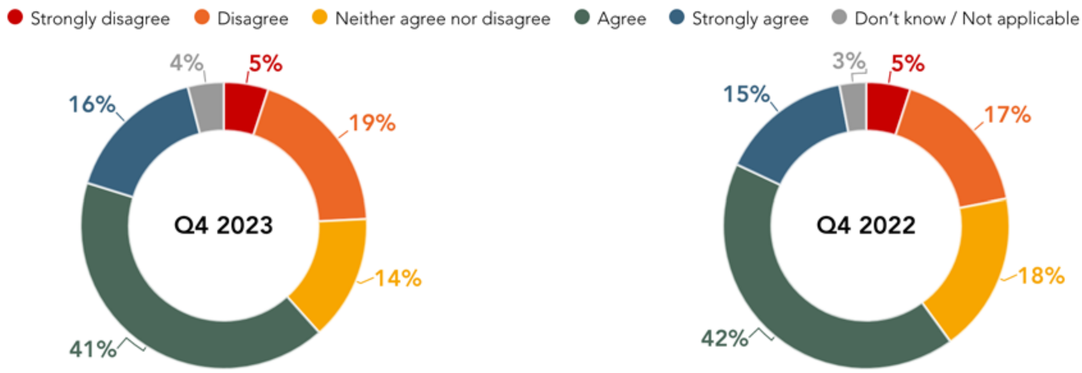
'The three lines model is still very important not only for clarity of roles and responsibilities but also crucially for ensuring accountability, and we see different banks practising this in different ways. For us, it is about combining assurance, not just finding the root cause but being more collaborative about how we can use the information to stay ahead of the risks before they pop out of one place and then later another,' explained an ACCA member in Canada who oversees operational risks from the second line. They continued:

> *Everything is moving so fast that if we don't put our heads together, we end up going through crisis mode instead of risk management mode, so we need to have a more integrated, holistic view,'*
> **ACCA member, Canada**

We find more 'heads of risk and internal audit' at non-financial corporates given the fact that the financial services sector is heavily regulated and requires chief risk officers and risk committees. Nonetheless, the push to enhance collaboration across the three lines varies firm-to-firm, with ACCA members talking a lot about getting the first and second lines to work together more on cyber and third-party risks and the increasing amount of reporting requirements, for example.

There was much discussion about the evolving relationship between risk and ethics and the pull between the two, including how ethics is also being integrated across the three lines. We increasingly see dedicated teams of ethics practitioners more involved in defining policies that help mitigate reputational and cultural risks. When it comes to banks, we often see ethics and compliance reporting to the head of risk or CRO.

FIGURE 8.1: Different roles still speaking different languages – Q4 2023 vs Q4 2022
(Risk is sufficiently discussed at all levels in the organisation)



Source: ACCA/IMA Global Risks survey (2023)

In our original risk culture survey completed at the end of 2022, only around two-thirds of all respondents agreed that internal audit could verify internal controls for conduct and culture risks and approximately one-fifth either disagreed, didn't know, or preferred not to say. We have not seen any improvement since then via our quarterly Global Risks Survey, and if anything responses in the second half of 2023 showed dwindling confidence in the ability of internal controls to ensure prevention of fraud and other business-critical risks, including those related to the integrity of accounting information of non-financial risks, particularly ESG risks. Responses to the open-ended question about 'the most unexpected risks' in our Global Risks Survey 2023 Q3 and Q4 also unveil some friction between who owns what, particularly when it comes to managing misinformation and disinformation.

Benn Pople, co-founder and head of risk talent, RiskTAE Limited, told ACCA banking members it is time to empower frontline business units by recognising them explicitly as the 'first line of defence'. He explained:

> *'This would be a subtle yet profound shift that reinforces the notion that risk management does not begin beside the business but within it.'*
> **Benn Pople, RiskTAE Limited**

ACTION POINTS

We see how traditional borders of the 3LOD have become more blurred as businesses deal with disruption from today's dynamic risk landscape and overlapping threats. This is why so many ACCA members are exploring ways to enhance collaboration and make decision making more efficient and effective.

- Today's risk landscape requires agility and dedication to the continual development of a more comprehensive knowledge of risk that promotes collaborative rather than segregated learning.
- Successful risk governance in the post-pandemic era requires a willingness to challenge conventional standards and embrace innovation and transformation.
- It is also during fast-changing times like these when diversity of thought and collaboration are most urgently needed so the organisation is not blinkered or stymied in its solutions when it can least afford to be.

Creating value when the 'three lines' work in harmony

By now it is generally accepted that risk management is everyone's business: understanding and embracing roles and responsibilities by key players in each of the three lines is crucial for effective risk management. This view was reflected in the rebranding of the 'three Lines of defence' model by the Institute of Internal Auditors (IIA) in 2020, when the word 'defence' was removed from the title to highlight the shift from defensive and reactive risk management to more proactive, collaborative approach. Principle Six of this model states: *'all roles working together collectively contribute to the creation and protection of value when they are aligned with each other and with the prioritized interests of stakeholders'* (IIA 2020).

Common derailers:

- Unclear roles and responsibilities as well as lack of coordination often result in coverage gaps or duplication of work performed, for example, who provides assurance and at what level of confidence for specific controls and processes – 2LOD vs 3LOD? Does a Unit Level Function (1LOD) or the Group Level Function (2LOD) cover AML compliance in the client on-boarding process?
- Unclear ownership of controls vs processes. This gets tricky where processes run through different functions and, as a result, the ownership is not obvious, eg the loan issuance process often encompasses a number of 1LOD and 2LOD functions.
- Absence of a common language between the three lines, resulting in discrepancies in methodology, including taxonomy. This occurs when there is 'no single source of truth' at an organisation, and different lines and/or functions within the lines refer to misaligned approaches, eg for risk, issue assessment and rating. These make the outcomes non-comparable and difficult to consolidate at an organisational level. As a result, risk intelligence users, including boards, receive multiple sets of incoherent risk information, which makes risk-based decision making difficult.
- Inconsistent application of the same methodology occurs where the level of capability for handling risk varies across the three lines, eg when 1LOD self-assessment outcomes are challenged by 2LOD and 3LOD, inefficiencies often occur where understandings of common methodology are not aligned.
- When there are competing priorities at functional or departmental levels across and within the lines, for example, when departmental KPIs include risk-related metrics, which polarise personnel from different lines, collaboration becomes challenging, with issues raised by 1LOD vs 2LOD vs 3LOD. In such cases, each party pushes its own agenda and overall organisational goals are not prioritised, for example, speed of issue identification and resolution in general.
- Miscommunication often leads to mismanaged stakeholder expectations, inefficiencies and conflicts across the lines.

Addressing common barriers:

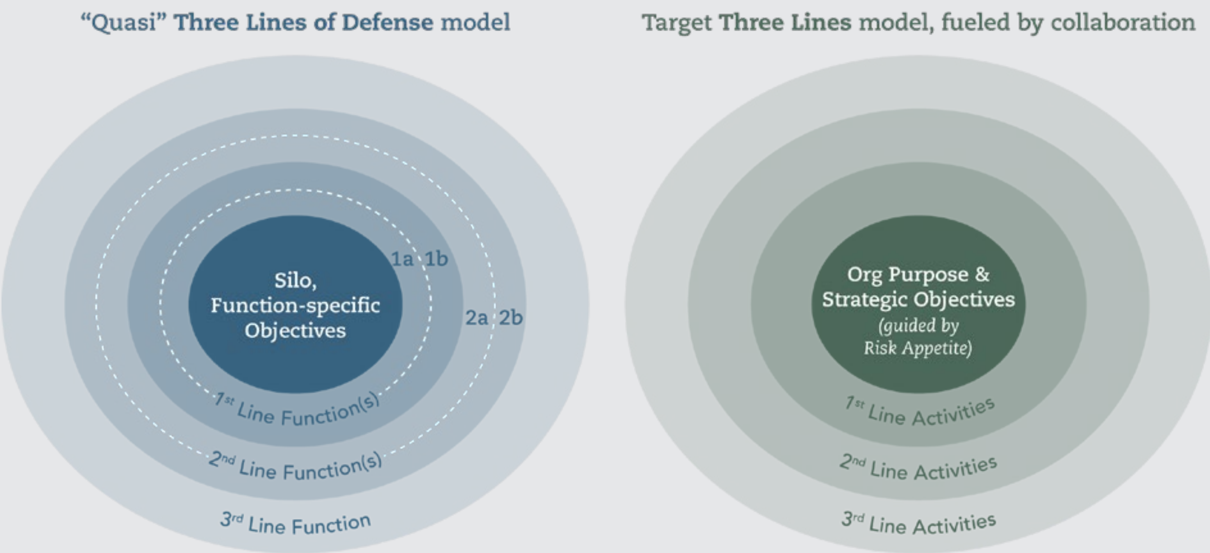
- Risk management roles and responsibilities – via RACI, responsible, accountable, consulted and informed (RACI), or another tool – operating at a functional level across the three lines, should be cascaded to all levels of staff via well-defined job descriptions and standard operating procedures, handbooks, and other guidelines.
- The approach to risk landscape mapping and management should be coordinated and pre-agreed, eg create a 'comprehensive assurance plan' for the organisation, where risk areas are prioritised in consultation with key stakeholders across the three lines and resources are allocated based on the organisation's risk appetite, ie where it is low, a higher level of assurance is planned by the most independent party, eg 3LOD as opposed to 2LOD. Also, process and control owners (1LOD) are consulted in advance, so that they contribute to the planning process and are able to commit resources to supporting assurance providers. Finally, such plans need to have in-built

Creating value when the 'three lines' work in harmony

flexibility to allow for changes in line with shifting organisational priorities. Naturally, surprise audits remain a 3LOD prerogative, where necessary.

- Risk and compliance taxonomy should be consolidated to enable common language, understanding and risk data comparability and aggregation across the organisation.
- Role-based capability profiling and training programmes are needed to ensure the above taxonomy/methodology is well understood and consistently applied across the three lines; including, additional role-specific training for specialised risk and compliance teams/other centres of excellence.
- Performance management and incentive schemes, including KPIs, should be aligned with overall organisational objectives and harmonised across the three lines.
- Management Information Systems should facilitate transparency, clarity and timeliness of the risk intelligence flow among key stakeholders to facilitate reliable, informed decision making. Often, this requires significant capital investment, both monetary and human, but the earlier this investment is made, the sooner risk landscape visibility and information alignment is made possible across the three lines.

FIGURE 8.2: Improving collaboration on 3LOD



The Blue diagram depicts the 'quasi' 'Three Lines of Defense' model, which often is an unintended consequence of some, or all, of the following factors at an organisation:

1. Focus on Silo/Function specific targets, misaligned with the Organisational Strategic Objectives.
2. The absence of a consolidated view of risk management (RM) activities across the organisation.
3. Often delinked from the Risk Appetite altogether.
4. RM related 'Roles & Responsibilities' AND/OR 'Key Performance Objectives' not being properly agreed, delineated, or harmonised across the organisation.
5. Attempts to align organisational structures to the superseded 'Three Lines of Defense' model, as opposed to focusing on the types of activities typical to specific lines and allocating owners as necessary (in accordance with the revised 'Three Lines' model by the Institute of Internal Auditors).

Collaboration and cooperation across all lines is instrumental in helping an organisation achieve its Strategic Business Objectives, so it fulfils its ultimate Purpose.

Source: Nino Gordeladze-O'Brien

By **Nino Gordeladze-O'Brien**, a consultant focusing on governance, risk and compliance, who has worked as head of enterprise risk management and deputy CRO and earlier Chief Audit Officer at the Bank of Georgia, LSE Listed, systemic bank in Georgia, and before that in the first and second lines at Westpac Banking Corporation, Sydney, Australia

WE INCREASINGLY SEE DEDICATED TEAMS OF ETHICS PRACTITIONERS MORE INVOLVED IN DEFINING POLICIES THAT HELP MITIGATE REPUTATIONAL AND CULTURAL RISKS.

9. Accountability is key for successful risk cultures

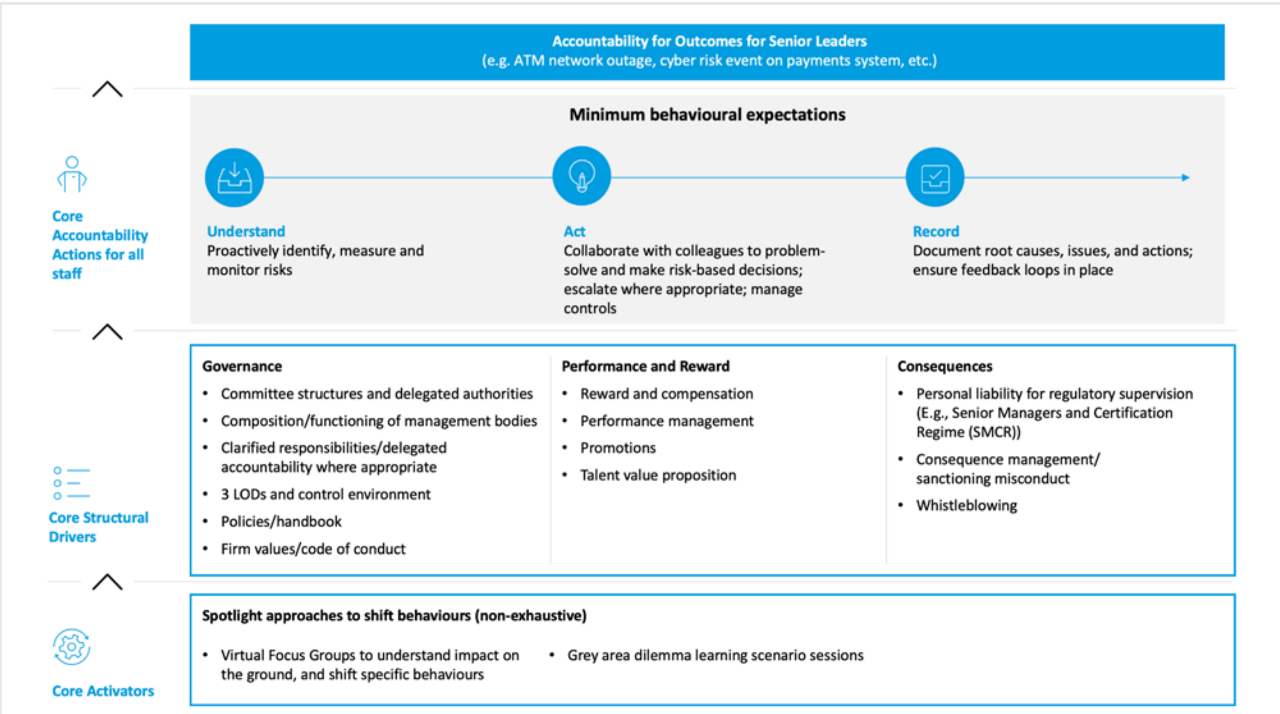
The failures of multiple banks in 2023 highlighted a lack of accountability across the three lines of defence, where accountancy and risk professionals come together. Firms should like to ensure that accountability is 'end-to-end' so that risks, especially non-financial risks, are appropriately managed across business units. They also should aim to reduce siloed or protectionist behaviours that compromise teaming, and ultimately damage group franchise value. The question is how to do this.

Institutions can ensure that accountability is embedded across teams by deploying structural *'drivers'*, which reinforce core actions so that senior leaders are ultimately accountable for outcomes within their remit.

Core actions for all staff

We see three actions as key: understanding, acting, and recording. It is important to first define and clarify what these actions mean in practice for employees across teams, and for leaders to delegate accountability where appropriate. There are a few watchpoints when doing this. Organisational accountability can often be seen as a 'leadership's problem'. Yet, each of us must deploy these actions as we participate in the business of taking risks – 'tone from the top' must be accompanied by 'tone from within'. A healthy way to embed this is to understand accountability as something we owe to our fellow colleagues, as professionals who deal with risks every day. To do this we have to examine our own mindsets, which drive accountability, our willingness to accept consequences. For example, admitting mistakes and course-correcting where needed, as well as being aware of how we present ourselves, so appearing attentive, dependable and reliable.

FIGURE 9.1: Accountability for outcomes for senior leaders



Source: Oliver Wyman

Core structural drivers

Employees must be appropriately motivated to embed accountability. Drivers may include governance, such as committee structures, 3LOD, and control environments, as well as performance and reward (incentives, recognition) and consequences (regulatory supervision, disciplinary management). Governance must ensure that accountability is not widely distributed through committees, but equally that shared accountability is present where required, for example, for operational leader and head of retail when there is an ATM outage. Incentives must balance the upside and downside of risk decisions to ensure that the culture is not one of fear that would disable the organisation, nor one that enables aggressive risk taking. Consequence management should also be strong enough that employees are sure about what are acceptable behaviours and what are not, but also balance an environment where people are psychologically safe and can raise issues through appropriate channels.

Core activators

Training and immersive culture activation sessions are one of the most effective ways of helping learnings 'stick'. This is because employees have the opportunity to discuss and learn from each other on knotty issues where the right answer is not necessarily clear. The ultimate goal of this type of scenario training is for a staff member to become aware of their own inclinations, preferences and biases that may lead them in a direction that differs from the path they would aspire to after this training. While it is helpful to widen awareness of options to choose from, it is important to curtail one's known inclinations, for example, to act impatiently, delay or defer, or keep problems to oneself until they are solved.

Moreover, receiving feedback on the impact of their behaviours can be very effective for both leaders and employees, enabling them to reflect on and adjust these behaviours. Oliver Wyman has been using virtual focus groups as a tool for understanding how staff on the ground think and react, and for appreciating instances of where accountability is going right or wrong. Here, participants log-in to a platform anonymously to express their opinions and react to other responses.

Building a strong risk culture requires a collective effort, with every employee embracing accountability as a fundamental set of three behaviours: understanding, acting, and recording. By implementing these drivers and activators, institutions can mitigate significant risks and foster a healthily balanced risk culture.

FIGURE 9.2: Grey area dilemma learning sessions

GREY AREA DILEMMA LEARNING SESSIONS

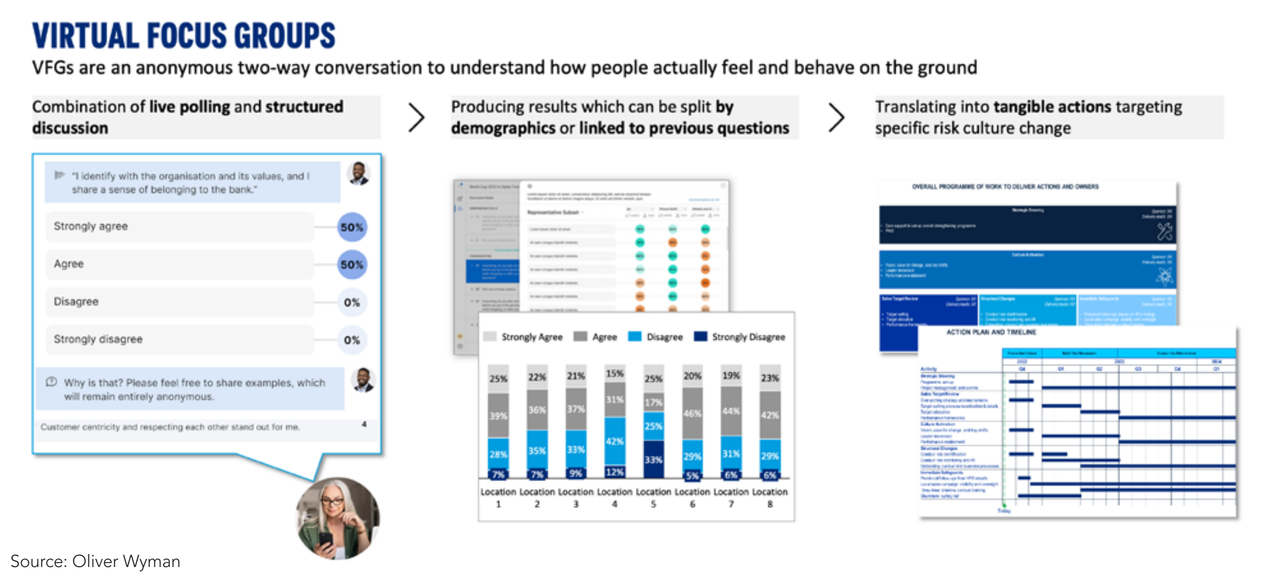
What are grey area dilemma learning sessions?
"Real-life" (previously encountered or potential high-risk areas) scenario-based group discussions with employees tailored to individual and business context to enhance employee understanding and confidence on how to make decisions around risk culture trade-offs

Example of similar discussions Oliver Wyman have facilitated:

#	Example dilemmas
1	You are responsible for a trade execution delay which resulted in a considerable loss to a client, who is now asking for a compensation
2	A client with whom you have a trustful relationship is insisting on having a structured investment product and you are uncertain whether the product's complexity and risk are suitable for the client
3	You notice a hardcoded value in the financial projection model, which inflates the outcome, but your manager is telling you to not be concerned
4	You overhear a rumor that one of your highest performing relationship managers is inflating their results by opening new credit cards for all their clients who apply for a term loan (in addition to the loan)

Source: Oliver Wyman

FIGURE 9.3: Virtual focus groups



Source: Oliver Wyman

By **Olivia Richards**
Partner at Oliver Wyman, specialising in risk culture

ACTION POINTS

ACCA members agree that the lack of accountability proved to be a major blind spot that all bank failures have laid bare. This is why it is critical for businesses to quantify and incentivise the risk culture they desire by ensuring everyone owns it and understands responsibility versus accountability.

- Good governance begins with role clarity, including understanding who is accountable for what. So, for each job, it should be specified where duty and ownership lie, but also where accountability lies. This is especially important for management positions since someone must be held accountable when even the most responsible person at the bottom of the chain fails or contributes to a failure.
- Successful risk cultures are more than a risk assessment or being compliant – success is about making well-informed decisions because we want to, not because we have to.

Closing remarks
by Pav Gill, Wirecard whistle-blower

Pav Gill
CEO & Founder, Confide

The Wirecard scandal serves as a poignant reminder to scrutinise the root causes of such catastrophic failures. The breakdown in control functions internally and externally was both systemic and systematic, begging the question of how such a spectrum of checks and balances failed so spectacularly.

Internally, an examination of the internal audit teams, legal and compliance structures, and corporate governance reveals a gap between their theoretical existence and practical effectiveness. Despite being on paper, how did they falter, and where were the blind spots? Can we attribute the failure entirely to these mechanisms?

Externally, the unchecked growth of this issue over two decades raises concerns. Despite numerous attempts to flag problems to the company, why did no one take any action? External audits and regulatory oversight also fell short, exposing a failure on multiple fronts, including law enforcement in Germany and other jurisdictions ignoring whistle-blower concerns and short-seller reports.

The key lessons involve introspection on how to move forward and where to focus our attention. On a personal and professional level, the takeaway is the importance of continuously addressing concerns and not shying away from raising them. Failing to do so risks becoming complicit in potential wrongdoings within a company. This perspective led me to establish Confide, a whistleblowing platform. Drawing from my experience as the head of legal and compliance for various companies and as a whistle-blower, I created a product designed to act as a risk management early detection tool, aiming to prevent future Wirecard-like situations. Confide provides employees with a safe space to report wrongdoings, mitigating against the risk of potential media leaks. It addresses the challenge of confiding in the right people, considering issues such as over-confiding or facing legal privilege and confidentiality restrictions.

To ACCA professionals, my only advice is to fulfil your job requirements with confidence. Be comfortable in the knowledge that diligent work leads to peaceful nights without concerns about negligence or oversight issues. Remember the intrinsic motivation behind choosing this profession and elevate your pride in contributing to a transparent and ethical financial environment. In conclusion, my message emphasises the need for vigilance, accountability, and the continuous pursuit of ethical practices to prevent the recurrence of scandals like Wirecard.

Pav Gill, CEO & Founder, Confide

Former head of legal (Asia-Pacific) for Wirecard, who exposed the failed fintech's suspicious accounting practices to the *Financial Times* and later the Suddeutsche Zeitung (*Financial Times* article 2021)

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Appendix

A: Evident KPIs

EVIDENT AI OUTCOMES REPORT

27 KPIs to assess AI outcomes

CAPABILITY AREA	KPI
Map	Does the bank have a central repository of the organisation's AI/ML use case portfolio?
	Does the bank have a common internal language for defining a 'use case'?
	Does the bank have a common internal language for defining 'artificial intelligence'?
	Total number of use cases
	Distribution of use cases across business lines or functions
Measure	Does the bank use a common measurement framework to assess the ROI of AI use cases?
	Does the bank assess all AI use cases against this ROI framework, at deployment and over time?
	The total revenue uplift from AI use cases
	The total cost reduction (or efficiency gains) as a result of AI use cases
	The total risk reduction (or avoidance) as a result of AI use cases
	The total customer satisfaction improvement from AI use cases
	The total staff satisfaction improvement from AI use cases
Ideate	Is there a formal process at the bank to capture ideas for AI use cases?
	Is there a clear approach to provide support to staff members generating ideas for AI use cases?
	Number of use case ideas generated within a given period
	Proportion of use case ideas generated by technical and non-technical employees
Prioritise	Does the bank have a common (centralised) evaluation framework to prioritise AI use cases?
	Proportion of use case ideas that are approved for POC development
	Time taken for a use case to get approved for POC development
Operationalise	Does the bank have a centralised platform for developing AI use cases which employees across the bank can access?
	Proportion of approved use case ideas that end up in POC
	Proportion of approved use case ideas that end up in deployment
	Time taken for an AI use case to move from approval to POC
	Time taken for an AI use case to move from POC to deployment
	Proportion of use cases that meet initial cost expectations
	Proportion of use cases that meet initial time expectations
	Proportion of uptake among target users of the AI use case

Source: Evident Insights (2023a) <https://www.evidentinsights.com/reports/evident_ai_outcomes_report?id=a2feabb9eb>.

B: Behaviours associated with a good risk culture

- Demonstrating a positive attitude towards the management of risk
- Considering risk in every business decision that is made, *before* the decision is made
- A good risk 'nervous system': strong and open communication channels where bad news travels faster than good news and escalation happens as soon as a problem or issue arises
- Taking responsibility for risks and controls, honesty, and clear ownership of risk
- Encouraging and educating others in the management of risk

Risks associated with bad conduct

Financial

- Profiting from dishonesty
  (withholding material information; 'greenwash' trades)
- Market disorder
  (rate-fixing)
- Excessive risk taking
- Customer detriment
  (ignoring 'duty of care'; mis-selling; trapping)
- Abuse of 'privilege'
  (conflict of interest; info sharing)

Non-financial

- Discrimination
  (favouritism; exclusion; ostracising)
- Abusive behaviour
  (harassment; 'culture of fear'; bullying; intimidating)
- Dishonesty
  (not transparent with the regulator, or mis-reporting – eg 'greenwash' marketing comms)
- Not talking *(or caring)* about Conduct or Culture

Source: adapted from Dr Roger Miles

C: Leadership case studies by Patrick Butler

EXAMPLE 1: In a European universal bank under a remediation programme, there was a senior individual who deliberately hired people who disagreed with him and this lead to a top-performing team with the lowest attrition rate. This approach, which values cognitive diversity, allowed the team to work on innovative solutions and address client needs creatively. This requires a bit of humility, not just filling diversity quotas to look good or maintain compliance. The team felt they were contributing to interesting solutions for the client, and that led to greater motivation. The critical success factor was the genuine value of creating a safe, positive environment for people to speak their minds, challenge dogma, and be innovative. This approach benefitted clients, the company, and shareholders. Cognitive diversity, rather than tick-box diversity, is key to a strong culture, eg a board with 50% women is not worth having if they act like men but meet an externally imposed target.

EXAMPLE 2: In a project to create a conduct risk framework, a senior banker at the UK branch of another European Investment Bank said they needed to wait for the old guard to retire. The problem is that without a conscious move by those at the top to set a different example, the same behaviour will be perpetuated. You see someone at the top, observe how they become successful and emulate that. Also, we must be aware that what leaders say is not always what is heard, and that unless a real effort is taken to instil transparency and joint accountability, you risk your people watching senior leaders and interpreting their observed behaviour as the way to succeed potentially in a way that creates perverse behaviour.

Leadership that is example-setting and transparent is key. To get those at the top to change (and align their personal aspirations with the behaviour that will bring value to the organisation), the cause and effect must be clear and compelling and done so through leadership, risk, and performance frameworks aligned with longer-term incentive programmes. This is what was behind the FCA's reform of bankers' bonuses since the early 2000s, ensuring these vest over years and having a clawback provision if misconduct comes to light down the track.

Human psychology tends to drive instinctive rather than rational decision making when under pressure. So, to integrate values into the business model, organisations must demonstrate the direct link between the desired behaviours and espoused values in a logical way using the 'slow' brain (as described by Daniel Kahneman). The value drivers are there, but they require inspired leadership to take a longer-term view of returns. The reward (not just remuneration) framework should be aligned with the behaviours that reflect these values and feed into the firm's strategy and purpose.

EXAMPLE 3: We created a financial model to show how a targeted programme of investment in behaviour would drive superior financial returns. It used logic and probability weighting to analyse direct and indirect drivers, such as staff attrition rates, regulatory intervention, and operational loss models. The return on investment was 25 to 40% per annum over 7 to 10 years.

This may sound like a Ponzi scheme, but it reflects the domino effect of a wave of behavioural change that aligns everyone with the firm's purpose, including the values of the firm, including those focused on customer service. This leads to increased engagement and productivity, leveraging the intellect and full potential of the greatest asset in a way that creates a positive feedback loop, resulting in sustainable, superior results.

The business case and analysis were presented to the board and new CEO, leading to the approval of the programme and its continuation eight years later. This approach can be applied to conduct risk, ethics, or ESG standards to create beneficial impacts on firms and society. The key challenge is to connect behavioural drivers, culture, strategy, and purpose, and build better metrics, motivation frameworks, and leadership to influence behaviours. This turns risk management and culture into a positive, value-creative business tool that drives success for all stakeholders, including yourself.

Patrick Butler is a former investment banker, chief operating officer and head of compliance, now a business transformation consultant, innovation venture founder, investor and board member, and core member of ACCA's special interest group on risk culture.

D: Designing responsible renumeration by Frederic Barge

1. Remuneration policy plays a crucial role in a company's success. It can be fixed salary for staff attraction and retention, or compensation in equity for long-term shareholder value and transitioning to a sustainable business model. It is essential to clearly define the remuneration policy's objectives before making design choices and understand how they help achieve company goals.

2. The remuneration policy should be designed to align with an institution's role in society and ESG ambitions, and how these influence its financial performance. Banks should focus on non-financial KPIs, including scope 3 emissions related to investment and loan portfolios, stakeholder reputation development, and effective risk management and ethical behaviours. Banks should do more to stimulate clients to reduce their scope 1 and 2 emissions. The environmental and social goals should be structured as a carrot, with the governance part as a stick. A carrot element results in a potential reward for success, while a stick element results in a reduction or reclaim of an incentive pay-out.

3. In terms of framing the process, remuneration decisions should be made by a well-informed and independent board. This requires the board to reach out actively to shareholders and stakeholders.

4. Companies should establish a clear, single storyline. They can do this by outlining their ambition levels (purpose), by demonstrating commitment to these ambitions by means of actions and input measures (practice), by transparently disclosing performance against the set ambitions (performance), and finally by demonstrating how leadership is held accountable in the pay-out of remuneration (pay). Distinctly linking the four Ps – purpose, practice, performance and pay – will strengthen the credibility of the organisation.

5. Lastly, when developing a pay strategy, it is critical to assess and ensure the fairness of prospective results about peer equity, internal and societal factors, as well as if such outcomes are fair representations of actual performance and serve the company's long-term goals. Such reviews must be performed again after the execution and payment are complete.

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