Institution: London School of Economics and Political Science		
Unit of Assessment: 17 – Business and Management Studies		
Title of case study: Influencing risk culture change processes in financial institutions		
Period when the underpinning research was undertaken: 2011-2020		
Details of staff conducting the underpinning research from the submitting unit:		
Name(s):	**Role(s) (e.g. job title):**	**Period(s) employed by submitting HEI:**
Michael Power	Professor of Accounting	1987 to present
Tommaso Palermo	LSE postdoctoral fellow; Lecturer; Assistant Professor of Accounting	2011-2013; 2013-2018; 2018 to present
Period when the claimed impact occurred: 2013-2020		
Is this case study continued from a case study submitted in 2014? No		

1. Summary of the impact (indicative maximum 100 words)

The global financial crisis of 2008-2009 focused new attention on a perceived culture of reckless risk-taking by financial organisations, especially banks. LSE researchers were invited to design and conduct research exploring how financial sector organisations dealt with their risk cultures. Key impacts of that research include:

- Contributions to understanding and influencing debate about risk culture within the financial services sector
- Contributions to new industry guidance in the UK and internationally
- Direct impacts on the measurement and management of risk culture within large financial organisations.

2. Underpinning research (indicative maximum 500 words)

The impacts described here are underpinned by LSE research led by Michael Power and Tommaso Palermo. Field-based research, drawing on observations and interviews alongside surveys and documentation analysis, was conducted between 2012 and 2015. At that time of heightened sensitivity for the financial services industry - and especially for banks - obtaining access to organisations was challenging but was facilitated by the Knowledge Transfer Network (KTN) board. Research access was ultimately permitted to nine organisations (six insurers and three banks). The researchers also had extensive contacts with professional service firms and were able to learn about their approaches to the development of a risk culture advisory product.

Fieldwork explored the ways in which financial sector actors, including consultants and regulators, conceptualised risk culture(s), including the tools and processes they use to measure, assess, and manage this. The aim was to develop a consolidated understanding of organisations' efforts to act on their risk cultures. To that end, the research explored issues including: the nature of risk culture(s); the ways in which companies understand and operationalise their own risk culture(s); the influence of financial regulators and consultants on these organisational conceptions; and the capacity for and consequences of consciously measuring, managing, changing and/or auditing risk culture(s). Key findings of the initial phase of the research were published in an industry report in September 2013 **[1]**. An interim report **[2]**, presented in November 2012, anticipated preliminary observations from the initial phase; it was instrumental in increasing the project's visibility and thereby expanding the range of participants.

Following the dissemination of these two research outputs, several non-academic research users expressed interest in an empirically-derived risk culture framework, initially developed for **[2]** and subsequently refined in **[1].** This framework concisely models different approaches to risk culture assessment and management and their potential trade-offs. Empirical data was collected through interviews with 61 individuals in financial institutions, professional associations, regulatory bodies, and consulting firms. This provided rich insights into risk culture in the financial sector from the perspective of different relevant actors. More granular data reflecting the work done on risk culture in specific organisations was also collected.

Further to exploratory interviews, a survey was run to collect data about specific aspects of business operations with potential relevance to the organisational risk culture (e.g. reactions to “bad” news, new product development policies, interactions between control functions and revenue-generating teams). The survey was itself followed up in each organisation by a focus group discussion, allowing the researchers to collect additional data by observing senior managers’ reactions to, and interpretation of, the survey’s findings.

A sustained relationship with [redacted] over the period July 2012-December 2015 allowed the researchers to observe a change process set in motion by the survey, and to remain engaged as the company evolved its approach to measuring and managing risk culture. A team within [redacted] risk function used the survey to collect data about risk culture from different business areas. Responses were discussed with senior management, including the Chief Executive Officer, Chief Risk Officer, and Chief Operating Officer. The researchers attended these (and follow-up) meetings and produced and shared with [redacted] customised reports analysing key findings at various stages of the research.

Five other organisations contacted the research team after the publication of **[1]** to learn about the findings and to share the results of their own internal risk culture workstreams. This led to substantial direct impacts on internal processes at insurance company [redacted], who contacted the researchers in September 2017. Over the two and a half years to March 2020, Palermo worked with senior members of the company’s internal audit function - Group Internal Audit (GIA) - on the development and refinement of a method to assess risk and control culture as part of the audit process. As part of this, he provided feedback on their existing methodology and shared the risk culture survey questions developed as part of the original risk culture project.

The insights published in **[1]** were supplemented and refined in a 2017 paper **[3]**. An additional academic output on accounting practices and managerial work was submitted in October 2020 for a third revision round in *Contemporary Accounting Research* (an ABS-4* and FT-listed academic journal). These papers make an important contribution to academic understanding of risk culture, adding novel insights to a growing body of literature on risk management and control practices. The specific empirical case of risk culture in financial organisations is used to generate broader contributions to studies of management innovations **[3]**. The research also compared risk culture in the financial sector with safety culture in high-risk sectors such as oil and gas exploration and the airline industry. A stand-alone comparator case **[4]** attracted considerable financial sector interest in understanding the potential to transfer insights and practices from the airline safety sector. In addition, the researchers published more practitioner-oriented outputs, such as a book chapter in a volume edited by a then-Partner and Head of Banking Risk at EY **[5]**.

Insights from this body of research relevant to impacts claimed here include:

- Confirmation that risk culture in financial services is based on trade-offs: good practice entails awareness of these, rather than being prescriptive about how much risk to take.
- Firms focus for pragmatic reasons on a few key issues, such as the relationship between risk functions and revenue-generating staff; the creation of new risk oversight units and capabilities; and dealing with new regulatory entities (e.g. Financial Conduct Authority).
- The research team used this insight to develop a suite of “smart questions” about risk culture for companies to use either as a stand-alone set or as a follow-up to diagnostic tools such as surveys (see **[1]**). The answers to these “smart questions” are specific and targeted, raising awareness about key cultural hotspots to address, but together they provide a useful snapshot of organisational risk culture.
- Consistent with the “audit society” thesis (see **[6]**, which informed the project’s broad conceptual approach), risk culture was shown to become “auditable” over time. This has significant managerial implications, since it frames corporate risk culture as something that can be inspected and validated by boards of directors and regulators.
- Despite heightened public focus on risk culture, the advisory market was observed to be challenging, with firms such as EY and McKinsey finding it hard to sell diagnostic tools as

stand-alone products. The research showed that risk culture must be combined with other issues such as risk governance or remuneration policies to catch on.

Research team contributions: Palermo and Power worked with Dr Simon Ashby (then at the University of Plymouth, now Vlerick Business School, Belgium). All three contributed equally to qualitative data collection during the original research (2011-2013). The analysis and write-up of final reports was carried out predominantly by the LSE team. Follow-up work (2013-2015) was done by the LSE team only and recent research at [redacted] by Palermo alone.

3. References to the research (indicative maximum of six references)

[1] Power, M., Ashby, S., and Palermo, T. (2013). *Risk culture in financial organisations: A research report*. Centre for Analysis of Risk and Regulation. ISBN: 9781909890046. Available at: http://eprints.lse.ac.uk/67978/

[2] Ashby, S., Palermo, T., and Power, M. (2012). *Risk culture in financial organisations: An interim report*. Centre for Analysis of Risk and Regulation. Available at: http://eprints.lse.ac.uk/47488/

[3] Palermo, T., Power, M., and Ashby, S. (2017). Navigating Institutional Complexity: The Production of Risk Culture in the Financial Sector. *Journal of Management Studies*, 54(2), pp. 154-181. DOI: 10.1111/joms.12241. JMS is a leading journal. This was one of its top 20 most downloaded papers from 2016-2017.

[4] Palermo, T. (2016). Technoculture: Risk reporting and analysis at a large airline. In M. Power (Ed.) *Riskwork: Essays on the Organisational Life of Risk Management* (pp. 150-171). Oxford University Press. ISBN: 9780198753223.

[5] Ashby, S., Palermo, T., and Power, M. (2014). Risk culture: Definitions, change practices and challenges for Chief Risk Officers. In P. Jackson (Ed.) *Risk Culture and Effective Risk Governance* (pp. 25-46). Risk Books. ISBN: 9781782720997.

[6] Power, M. (2007). *Organized uncertainty: Designing a world of risk management*. Oxford University Press. ISBN: 9780199253944.

4. Details of the impact (indicative maximum 750 words)

The work described here has had both direct and indirect impacts on financial services sector organisations around the world. Although the aim of the underpinning research was not to develop a new tool to measure risk culture, it has supported industry efforts to do so. Three specific areas of research impact are outlined below.

Informing, understanding, and influencing debate about risk culture within the financial services sector

The project report **[1]** and additional practitioner-oriented outputs (e.g. **[5]**), were shared widely among financial organisations including banks, insurance companies, and industry regulators, and have become a reference point in the risk culture debate within the sector. The reach of this work's influence is evident in the wide range of regulators, professional bodies, and advisory firms citing it in policy and guidance documents and inviting the researchers to present evidence from it to senior staff. Invited presentations and feedback on corporate change programmes and the design of risk culture assessment tools have been given, among others, at: the Prudential Regulation Authority/Bank of England (February 2014); Risk Minds Insurance (March 2013); the Risk Management Practitioners Group at the Investment and Life Assurance Group Limited (April 2014); and the University of Cambridge Judge Business School's 8th Risk Summit (June 2017), which brought together leaders and decision-makers from business, governments, and NGOs, as well as academia. The researchers have also discussed **[1]** at private meetings with independent statutory bodies such as the Australian Prudential Regulation Authority (APRA) and the Chartered Institute of Internal Auditors (CIIA); banks including Royal Bank of Scotland and Irish Allied Bank; and consultancy firms such as McKinsey.

The project's contribution to industry understanding and debate about risk culture is corroborated by industry colleagues using the research. These include the Managing Director of a Sydney-based advisory and consulting firm - who has extensive experience in UK and Australian financial institutions, and within the regulatory community - who writes:

> *"In my view, [the researchers] have contributed significantly to the corporate and regulatory sectors' understanding of risk culture…For both corporate and regulatory actors…[their] work has contributed both credibility and clarity - both of which are key to transitioning from curiosity in a concept, to practical application."* **[A]**

A further testimonial was provided by the CEO of the Lighthill Risk Network, an organisation funded by the insurance industry to facilitate knowledge transfer into business from academic, government, and commercial experts. They state that the study: "s*tarted to change the narrative around risk functions and governance away from purely quantitative and methodological needs to a culture where behaviour and cognition became understood to be an intrinsic part of the discussion"* **[B]**.

Non-academic research users have been particularly interested in the framework presented in **[1]**, **[2]**, and **[5]**, which concisely models different approaches to risk culture assessment and management and their potential trade-offs. A former partner at EY and senior regulator at the Bank of England explains:

> *"The research…put a more rigorous framework around the discussions of the implications of different organisational structures for risk-taking; in particular, more complex organisations might be driven beyond their bandwidth for risk-taking by specific hot spots in the organisation. This focused attention on the need to consider the trade-offs between risk taking and controls."* **[C]**

Informing new industry guidance in the UK and internationally

Both because of direct engagement and through independent uptake and use of key outputs, the research has informed new industry guidance aimed at improving understanding, monitoring, and development of risk cultures in the financial services sector around the world. By providing input into the work of national and international regulators and professional bodies, it has contributed to their efforts to improve financial stability.

In January 2014, the researchers drew heavily on **[1]** in submitting written feedback on a consultation document published by the Financial Stability Board (FSB), an international body which monitors and makes recommendations about the global financial system. **[1]** was cited in the resulting FSB report, "Guidance on supervisory interaction with financial institutions on risk culture: A framework for assessing risk culture" **[D]**. Published in April 2014, this new guidance was intended to help supervisors assess the soundness and efficacy of a financial institution's risk culture. As with other FSB publications, its intended users are the financial institutions of the world's largest economies, international financial institutions (e.g. the International Monetary Fund and World Bank), and international standard-setting organisations (e.g. Basel Committee on Banking Supervision and the International Accounting Standards Board). The FSB report **[D]** has become a central reference point for corporate and regulatory initiatives on risk culture.

Additional examples of policy and guidance citing **[1]** include:

- Guidance on the development of a "sound risk culture" published in 2015 by the CRO Forum, a group of Chief Risk Officers from large multinational insurance companies which develops and promotes industry best practices in risk management **[E]**.
- CIIA guidance on "Culture and the role of internal audit: Looking below the surface", published in 2014 **[F]**. The CIIA has approximately 9,000 members; it represents internal auditors in the UK and Ireland. The research, in particular **[4]**, also informed CIIA input to the Financial Reporting Council-led "Culture Coalition". Initiated in 2015, the Coalition brought together regulators, company chairmen and CEOs, leading industry experts, and academics to explore how corporate cultures are defined, embedded, and monitored, and how they contribute to long-term value. A CIIA Senior Policy Officer confirms that both **[1]** and **[4]** "*influenced the CIIA's thinking and policy development"* **[I]**.
- An October 2016 Information Paper on risk culture, published by the Australian Prudential Regulation Authority (APRA) **[G]**, an independent statutory authority supervising banking,

insurance, and superannuation institutions and promoting financial system stability in Australia. It published the Information Paper for APRA-regulated institutions working to understand and manage their own risk cultures.

The research was also referenced in a speech given in March 2015 by the Executive Director of the Securities and Futures Commission (SFC) of Hong Kong, the independent statutory body charged with regulating Hong Kong's securities and futures markets. The speech addressed ways in which the SFC could improve supervisory approaches to ensuring integrity in financial markets **[H]**.

Direct impacts on the measurement and management of risk culture within large financial organisations

The collaborative nature of the research helped to deliver direct impacts in participating organisations seeking to measure and manage their risk cultures. An indicative example is [redacted], the [redacted] subsidiary of global insurance company [redacted]. [redacted] employs approximately [redacted] worldwide, [redacted] of them in the UK. They made extensive use of the survey tool designed by the researchers, focusing especially on revealed variations in risk-taking across functions and the problem of compliance "gold-plating". Internal discussion of the survey findings resulted in the launch in Autumn 2014 of a new corporate training initiative on decision-making. Internal audit also adapted the survey for their own audit of risk culture, which led to a re-focus on developing risk metrics.

While impacts at [redacted] were relatively short-term (the work informed specific, time-limited organisational initiatives), the research has informed ongoing effects at [redacted] multinational financial services company [redacted]. [redacted] Group Internal Audit (GIA) function has used direct feedback from Palermo, alongside insights published in **[1]**, to revise its methodology for assessing risk and control culture. The revised method both makes it easier to conduct the audit and improves comparability across audits. It was implemented at [redacted] from April 2018 and has since been used in all audits conducted by the GIA. Research engagement with [redacted] continues, but their [redacted] confirms its impact to date on research on organisational processes and methodology relating to risk culture:

> *"We have been developing our approach to measurement of risk and control culture over several years … [Your research and input] has been taken into account as we make further refinements to our approach. Your comments related to the potential behavioural impacts of various methods have been particularly useful*." **[J]**

5. Sources to corroborate the impact (indicative maximum of ten references)

[A] Supporting statement from Managing Director, Kiel Advisory Group, 16 February 2019).

[B] Supporting statement from CEO, Lighthill Risk Network, 21 June 2018.

[C] Supporting statement from former Partner and Head of Banking Risk and then the Head of Financial Regulation at EY, previously Head of Financial Industry and Regulation Division at the Bank of England, 20 September 2019.

[D] "Guidance on supervisory interaction with financial institutions on risk culture: A framework for assessing risk culture", Financial Stability Board, 7 April 2014.

[E] "Sound risk culture in the insurance industry", CRO Forum, May 2015.

[F] "Culture and the role of Internal Audit: Looking below the surface", Chartered Institute of Internal Auditors, July 2014.

[G] "Information Paper: Risk Culture", Australian Prudential Regulation Authority, October 2016 (p. 8, n. 4).

[H] "Integrity in financial markets and SFC's enhanced supervisory approach", speech given by Executive Director, Securities and Futures Commission, 5 March 2015.

[I] Supporting statement from previous Senior Policy Officer, Chartered Institute of Internal Auditors, 16 November 2018.

[J] Supporting statement from [redacted].