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Strategy, Governance, Culture and Conduct

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Culture and Conduct

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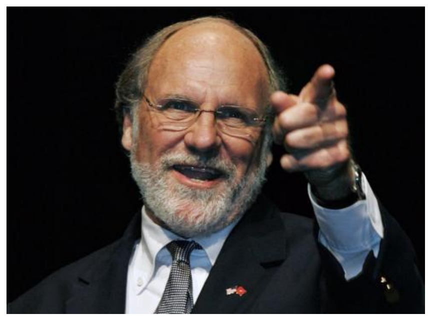
MF Global

- What happened?
- Why did it happen?
- What specific governance/cultural aspects allowed the event to unfold?
- Whose conduct was at fault?



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JPMC

- Jamie Dimon had a reputation for being a strong risk manager
- JPMG is acknowledged as the forefather of VaR and in the area of operational risk, highly regarded as being comparatively advanced to most other firms
- So, how did the "London Whale" affair ever occur?
- In what way was/is JPMC's governance at fault?
- To what extent did culture and conduct collide?
- Why was the conduct condoned?

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Operational Risk – the study of behaviour

- The Basel II definition is causal by nature…..
  - People, processes, systems and external factors
- Human behaviour is extremely uncertain – why do people do what they do when they do it?
- OpRisk management wishes to become more proactive and preventative – hence we need to focus on why people do what they do when they do it…..
- The only manner to address this challenge is to embark upon detailed causal analysis of what drives our OpRisk exposures…..or why our people do what they do....

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Governance

- The core governance structure sets the initial tone for the overall culture of the firm
- The governance structure translates into the strategic objectives which the firm wishes to achieve, which in turn drive the business objectives for management
  - Unrealistic or aggressive objectives will foster a "succeed at all costs" culture
  - The lack of objectives or easily achieved objectives will foster a "who cares" culture
- Poor culture facilitates adverse or unexpected conduct.

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Culture

- The set of common beliefs, behaviour, approaches and ethics shared across the primary stakeholders of a firm, which govern the way in which the firm conducts itself and undertakes business activity.
- Culture is driven from the governance structure and the strategic objectives of the firm – stakeholders at odds with the culture tend to vote with their feet.
- Culture drives, controls and initiates conduct.

Ergo Insurance Group

- May 2011 – firm hit the headlines after rumours of it spending €83,000 on a sex-trip for sales staff to Budapest
- September 2012 – firm hits headlines again when an audit report exposed a €2,430 brothel trip to Majorca for sales staff and a €75,000 trip to the “Hedonism II” swingers hotel in Jamaica for management
- Senior management knew and participated – what kind of culture did Ergo and its subsidiaries have? What kind of sales conduct could we expect to see?

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What is conduct risk?

- **A definition**: Unexpected or undesirable behaviour by management, staff or other person identified with the firm which results in an adverse impact or consequence for the firm.
- How do different stakeholders perceive conduct risk?
  - The regulator(s)
  - Clients and counterparties
  - The Board and executive management
  - Business management
  - Staff
  - Business partners, service providers, vendors
  - Competitors

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ING : Australia's 2nd largest fraud

- 40 year-old Rajina Subramaniam worked for ING in Sydney for 20 years as an accountant.
- Embezzled AUD 45,000,000 between 2004 and 2010 by transferring suspense account balances and unclaimed client money to personal accounts.
- Became known throughout Sydney for her lunch-hour shopping spree's – in 2009 alone:
  - Chanel (AUD 98,452)
  - Bulgari (AUD 3,300,000)
  - Paspaley – a jewellers (AUD 7,600,000, over and above AUD 16,000,000 in previous years)
- Also bought 7 properties in her maiden name.

- Reason for the fraud – not valued or respected, manager delegated everything to her

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Conduct risk appetite

- What is the firm's risk appetite for conduct risk?
- What percentage of budget is spent on training?
- How are staff incentivised? Penalised?
- Is there an accepted whistle-blowing mechanism?
- Are appraisal issues and staff complaints followed up on?
- Is HR part of risk management or just another services unit?
- Does the firm's culture allow for a "favoured few"?
- Is there a common culture group-wide?

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Tools to measure and manage conduct risk

- Primary implication of adverse or unexpected conduct is reputational consequence, followed by financial impacts
- Establish a barometer of reputation and thus of conduct and then monitor on an ongoing basis, the delta in the barometer
- Include aspects such as:
  - Staff and client satisfaction surveys
  - Adverse and positive press mentions
  - Internal and external complaint levels
  - Deviations in product take-up or profitability levels
  - Fluctuations in ratings, analyst opinions or share price
  - Social media gossip

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Questions and Comments

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