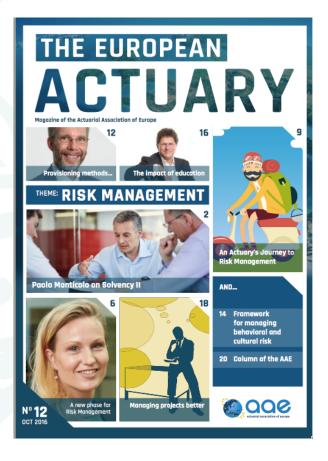# **Society of Actuaries in Ireland**

Assessing, Quantifying and Managing Agency Risk

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Interview:
Clifford Friend
Advocating a lifelong
passion for learning

Regulation
Keeping actuaries
informed on ethical
issues and big data

Insurance
Principles and
privacy on pooling
genetic data

Soft skills
Introducing
monotasking for
mental productivity

BEASTLY BEHAVIOUR

Assessing and managing cultural risk

THE EUROPEAN ACTUARY

Magazine of the Actuarial Association of Europe

12 Provisioning methods...

16 The impact of education

9

THEME: RISK MANAGEMENT

2 Paolo Monticolo on Solvency II

An Actuary's Journey to Risk Management

AND...
14 Framework for managing behavioral and cultural risk

20 Column of the AAE

6 A new phase for Risk Management

18 Managing projects better

Nº **12** OCT 2016

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Content

- What is agency risk? What is the current narrative?
  - The inadequacy and problematic nature of this narrative
  - Necessity to consider behavioural and cultural risks
- A framework for assessing behavioural and cultural risks
- Quantifying these risks
- Progressively managing the risks

What is agency risk? What's the current narrative?

- Principal-agent problem (Economics) – agent not acting in the best interests of the principal hiring them
  - Reasonably broad narrative
- Agency risk (ERM) – the misalignment of interests between the agent and the principal
  - Some loss in the narrative, but with focus added
- Asymmetry of information – agency risk narrative often deepened to include this issue
  - Inadequate, problematic and distracting narrative

Problems with the current narrative

No mention of behavioural and cultural risk

Why?

- The elephant in the room – ego, character

Source: Forbes.com

- Agency risk about agency risk – we're all mostly agents

- No obvious or easy existing solution

    – wide recognition of the problems arising from agency risk but most are at a loss of what they can do about it

- It's not for the faint hearted – easy to shy away from dealing with it

- Expertise needed – which can be in short supply

- Deep narrative needed – otherwise may make it worse

Framework for assessing behavioural and cultural risks

- Principles of progress
  - Openness to thought, reason, persuasion
  - Courage and action
- Obstacles to progress
  - Hubris and brutality
- Constraints on progress
  - Cultural
  - Behavioural
- Model to assess, quantify and manage the risks

Cultural constraints on progress

1) Attachment to the status quo (don't shock the system)

2) Existing power structures based on self-interest (protect the establishment)

3) Rigid hierarchies (don't upset the balance of power)

The difficulty overcoming these is an indication of cultural risk

This is achieved by courage, willingness to challenge, strong benevolence, doing the right thing, seeing justice done.

Behavioural constraints on progress

- When behaviour differs from the ideal
- Four broad categories of behaviour:
  - Citizens
  - Egotists
  - Conformists
  - Brutes
- In reality, people usually demonstrate a combination of all four types of behaviour to some extent, the relative balance being the important factor.

Citizens

"To be a man/woman is, precisely, to be responsible. It is to feel shame at the sight of what seems to be unmerited misery. It is to take pride in a victory won by one's comrades. It is to feel, when one is setting one's stone, that one is contributing to the building of the world." – Saint-Exupery

"Most powerful is he who has himself in his own power." - Seneca

Citizens are responsible, self-reliant and self-ruling. They are willing to participate beyond their own self-interest for the greater good and have a general care for others.

- With citizens, justice can win out over expedience.

- Citizens are a necessary pre-condition for progress.

Egotists

"When the whole state is on the right course it is a better thing for each separate individual than when private interests are satisfied but the state as a whole is going downhill." – Pericles

Egotists are responsible, self-reliant and self-ruling, <u>but</u> their efforts to participate beyond their self-interest, and the interests of those close to them, is marginal or non- existent. They have less care for others than Citizens and are more open to actions for selfish reasons, which are detrimental to others. Egotists present a behavioural risk when self-interest is not properly aligned to achieving progress.

- By failing to fully rule themselves, egotists create a power vacume. They can be open to the idea of having a **tyrant** or 'benevolent dictator' as long as their interests are being met or being furthered.
- Egotists are at risk of turning into these tyrants - seeing it as a good thing.
- Egotists create cultural/political risk and an optimum cultural/political environment (a democracy) is not possible with them.

Conformists

"For those who are politically apathetic can only survive if they are supported by people who are capable of action. They are quite valueless in a city which controls and empire, though they would be safe slaves in a city that was controlled by others." - Pericles

"Those who do not rule themselves, need to be ruled by others." - Aristotle

Conformists cannot, or will not, rule themselves. They are inclined to be slavish and willing to sacrifice some freedom in return for reducing their responsibility. They seek security through being dependent on a master or ruler, in order to have a quieter life. They are unlikely to initiate significant progress, since their aim is often to find a more 'benevolent ruler'. They represent a more passive type of behavioural risk.

– By not ruling themselves, they create a power vacume which needs to be filled for reason of expedience – they want a ruler to rule them.

– Can be **critics**, **moaners** or **radicals**.

Brutes

"Barbarians have nothing trustworthy or true." – Herodotus (said by the Spartans to the Athenians)

Brutes are willing to be brutal and mindless in their actions if they consider it in their interest. They are cowards who are typically enemies to anyone better than themselves, who often despise those who treat them well and look up to those who make no concessions but are mostly filled with nonsense. Their consideration for others is often quite limited. Brutes typically want to bring things down to their level and are the greatest behavioural risk in any organisation.

- Power vacumes are likely to attract or necessiate brutes for reasons of expedience.
- Can be **trolls, sadists** or **psychopaths**.
- What's the difference between a brute and a gentleman/woman?

Model to assess, quantify and manage the risks

The human condition:

- Our perceptions are created by our egos, which can filter and distort reality to deal with setbacks or other difficulties in order to make us feel good and keep going. The healthiest egos are those with the least distortions.

- Life is analogous to a hill, which is initially steep but flattens on ascent. This makes progress more difficult than regression. We progress/ascend according to how much we require of ourselves. Resources can flatten the hill but not change its shape. Our rewards for ascending the hill are that better terrain opens up to us and future progress is less difficult, and vice versa. Different levels of the hill might be regarded as different levels of human nature, with 'full-humanness' being at the top of the hill.

- Our psyches have three elements – reason, thought and passion (in our head, heart and guts respectively).

Model to assess, quantify and manage the risks

The human condition:

- Human interaction is necessary, creating additional constraints that can be either progressive or regressive. Other factors, such as knowledge, understanding, expertise, energy, or time, can limit our constitutive elements for building the world and the way we look at things.

- These limitations imply that a degree of humility is necessary to achieve some sense of realism. To ascend the hill requires pessimism (owing to the nature of the hill) and for us to be ego critical (to overcome ego distortions). We also need to be positive overall, so that any 'negativity' arising from reasoning can be overcome by courage, patience, confidence and optimism.

- The most common example of ego distortion is seeing the route to progress in our thoughts and passions being achieved by obtaining more resources. Those further up the hill typically have the more progressive perspective that requiring more of themselves is the key to success.

Model to assess, quantify and manage the risks

Comparing the four behavioural types:

- In order to carry out the same action:

    - The Citizen requires more of themselves than the Egotist (by considering others more)

    - The Egostist more than the Conformist as they are willing to rule themselves

    - The Conformist rather than the Brute as they are willing to adjust to norms.

- Each behavioural type represents a different level on the hill

- Each has distortions to their egos in proportion to where they are on the hill

Assessing and managing behavioural risk

"The only medicine for suffering, crime, and all the other woes of mankind is wisdom." – T. H. Huxley

Know Yourself Test:

Aim: To help you be the best you can be – by helping you know yourself more

- By highlighting progressive viewpoints that are likely to aid you being the best that you can be.

- By highlighting common distorted viewpoints that can hinder you from being the best that you can be.

- The underlying theory is based on classical thought but is also consistent with the work of Maslow who famously studied highly functioning, high achieving self-actualized individuals.

It's effectively a health check for your ego that can affirm progressive perspectives and help offer remedial actions to counter regressive perspectives.

- Just like going to the doctor for a general health check.

Assessing and managing behavioural risk

"The only medicine for suffering, crime, and all the other woes of mankind is wisdom." – T. H. Huxley

Know Yourself Test:

The test works in the following way:

- Egos can be assessed because we are mostly unaware of our own ego. Otherwise the distortions would not have the desired effect. The test's methodology uses a person's ego against itself in order to reduce gaming.

- Different psychological perspectives are assumed to be associated with different positions of the hill.

- An individual's position on the hill is assessed according to the extent to which they hold certain different perspectives. Forty such perspectives are the basis of the questions in the test. Answers to these questions are scored to quantitatively assess the extent to which a person is reaching '*full-humanness*'.

Assessing and managing behavioural risk

"The only medicine for suffering, crime, and all the other woes of mankind is wisdom." – T. H. Huxley

Know Yourself Test:

- Four coefficients are output from the test, indicating (1) where the person is on the hill, (2) the quality of their logical and rational thinking, differentiating between rationality and pseudodoxia (distorted logic), (3) the degree to which they put thought into their work, and (4) the degree to which the person is behaving merely prudently or in a superiorly prudent manner.

- The overall methodology has been tested in focus groups and trialled to enable statistical testing of the results. These indicate moderate-to-strong levels of reliability and validity. Feedback is also provided by the test to indicate the changes in perspective that can help a person reach their full potential through achieving better levels of self- realisation. A number of companies have recently begun using the test as a tool for assessing and managing behavioural risk, as part of initiatives to improve their business performance.

Assessing and managing behavioural risk

"The only medicine for suffering, crime, and all the other woes of mankind is wisdom." – T. H. Huxley

Examples of how is can be used in practice:

Direct use

- Direct assessment of individuals to assess their behaviours, e.g. interviews.

Indirect use – the 'Know Yourself Training Course':

- Helps individuals see how their perceptions are helping or hindering them in a indirect and non-confrontational manner that maintains _psychological safety._

- Helps individuals see the consequences of their perceptions and the impact on their attitudes and choices, e.g. how their perceptions can distort their judgment

- Helps individuals change their perceptions so that they be the best that they can be – which includes helping resolve conflicting and confusing perspectives.

- It also helps provide a degree of education for their hearts and their guts.

Specific examples

Assessing and managing cultural risk

What is Risk "Culture"

-   There are a number of different definitions for risk culture but they all share an emphasis on behaviors, values and ethics.

-   Risk culture is also dynamic and can change at a macro and micro level as attitudes of the individuals in the organization change.

The aggregated human condition - the team ego – team culture

-   People do not exist independently – they influence and are influenced by the group to which they belong

-   Team egos exist in a similar way to which egos exist – the team narrative in which individuals interact typically includes different degrees of distortions.

-   The healthiest team egos are the ones with the least distortions to their narratives.

Assessing and managing cultural risk

Elements of a healthy Risk "Culture"

- Meaningful, positive activity
  - Focus on cultivating growth, not resisting decay
  - Line of greatest advantage favoured over the line of least resistance.
  - Functional rather than merely mechanical processes and systems.

- Open, collaborative, safe culture of challenge
  - Psychological safety to challenge existing narratives rather than just analyses.
  - Rich, sophisticated narratives, driven by engaged citizens not dominated by egotists / brutes
  - Powers not abused
    - Unconstrained self-interest not being tolerated to the detriment of the team.
    - No destructive behavioural issues, e.g. negative projection, DARVO or sadistic bosses.

Assessing and managing cultural risk

Cultural (team) norms make progress up the hill more difficult

- To be part of a team is usually to be enculturated – to adopt the same "norms"

- On entering the team, we see these as "norms", but they start to disappear from view as we adopt them:

  - Common ways of talking about things (**linguistic norming**)

  - Common ways of getting things done (**social / technical norming**) – including common reuse of examples, previously created spreadsheets etc etc

  - Ubiquity of concepts makes them less likely to be challenged (**black boxing**)

- Provides ready made templates for understanding, coordinating and engaging with the world

- Lowers the cognitive load of engaging with the world (makes life simpler)

Assessing and managing cultural risk

Challenging the norms, challenging the culture

- The norms can be fine as long as events unfold within the expectations of "business as normal"

- In uncertain times, need to know when normal is no longer normal

- Need to raise the narrative
    - Challenging the norms, unboxing the black boxes, questioning the language and world view
    - Increasing the "cognitive load" for everyone

- **Unhealthy team ego** - challenging norms directly challenges team identity

- **Healthy team ego** – challenging norms is part of team identity

- Responsiveness requires healthy dynamic instability, ongoing challenge…
…not inertia, closure, stasis

Assessing and managing cultural risk

Four behavioural responses to challenge

The citizen – willing to unpick the narrative, challenge norms and bear the cost of reconstruction – when appropriate

The egotist – knows things could be different but only accepts challenge when cost is lower, or personal gain is sufficient

The conformist – changes only with the team norms – price of challenge always too high. Ruled by the team. At risk from brutish behaviour.

The brute – punishes any challenge to the group "for the good of the group" (for reasons considered expedient). Sometimes useful for pure expedience, but comes with a big cost and is usually very dangerous.

Assessing and managing cultural risk

Teams with healthy egos

- Encourage challenge
- Psychological safety
- Encourage citizenship not conformism
- Ostracize egotistical and brutish behaviour
- Can face change outside the "norms"

Unhealthy team egos

- Oppose challenge
- Lacking psychological safety
- Citizenship can become too dangerous
- Can allow brutish behaviour to exist or even dominate
- Through the tacit approval or acceptance of conformists
- Survive within the "norm", fail outside the "norm"

Assessing and managing cultural risk

Model for assessing cultural risk – the Know Your Team Test:

- Compares health in the team ego with health of individual ego
  - Combined with observation of the team in action
  - Can help quantify dominance risk
  - Highlight team members adding to or taking away from team culture
  - Can propose self-realisation and other remedial actions to improve the progressive nature of a culture.

- Could compliment Know Your Team test with other levels of analysis
  - E.g. Social network analysis – helicopter view of the structure of relationships within organisation, revealing how hierarchical relationships are between and within teams

Assessing and managing cultural risk

Know Your Team Test – examples of how it can be used:

- Helping CEO understand group dynamics and culture of the board

- Help teams work better together to achieve more

- Help resolve uncertainties, confusion and frustration resulting from unresolved team ego issues

  - Is your boss actually a sadist – or are you lazy?
  - Accurate analysis shows the need for corrective action

- Like a family health check –spot problems which are difficult to see, and help highlight and encourage more healthy behaviours.

Summary

- Problematic existing narrative for agency risk
  - Preventing adequate management of agency risk
- Alternative approach using a model of the human condition to bring to light behavioural and cultural risks
- Know Yourself Test and the Know Yourself Training Course
  - New actuarial approaches for managing behavioural risk
- Know Your Team Test
  - New actuarial approach for managing cultural risk
- Comparable to getting a health screening for yourself or your team
  - Not something anyone likes doing but you'll probably feel better afterwards
  - Better than shoving issues that you're worried about under the carpet.

Disclaimer

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