Behaviour and Culture in the Dutch financial sector
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Introduction: supervision of behaviour and culture

One of the lessons learned from the crisis and major incidents that have occurred since is that behaviour and culture at financial institutions can significantly influence the risk profile of these institutions. This is why De Nederlandsche Bank (DNB) has since 2011 explicitly supervised behaviour and culture at supervised institutions. This complementary form of supervision contributes towards answering the following questions.

- Which – positive or negative – influence do individual actions and group dynamics have on the financial performance, integrity and reputation of an institution? And which facilitating or restraining role does the institution’s prevailing culture play?
- Which measures are necessary to mitigate the risks related to human behaviour as much as possible?

For DNB, supervision of behaviour and culture has proved a valuable supplement to the more traditional forms of financial supervision. Our examinations have shown that a great deal of supervision issues and incidents are rooted in behaviour. By addressing these root causes, we can make a valuable contribution to solving problems in supervision, and we can prevent history from repeating itself. So supervision of behaviour and culture is not aimed at dealing with symptoms only, or at providing quick fixes, but it targets sustained change. This is also because DNB keeps monitoring supervised institutions over longer periods of time until the envisaged behavioural change has been achieved.

Attention for behaviour and culture has also improved the clout of financial supervision, as supervision has become increasingly forward-looking. Indeed, problems on the behavioural front can often be discerned before the financial performance of organisations gives cause for intervention. By addressing behavioural risks at an early stage, larger financial and integrity problems can be prevented.

Like the traditional forms of supervision, supervision on behaviour and culture is risk-based. This means that we focus primarily on institutions with supervisory issues or institutions that have a big influence on financial stability in the Netherlands.
Vision and principles

DNB acts on the premise that all institutions are responsible for their own business operations and the accompanying behaviour and culture. We only verify whether or not the attached risks are managed adequately. This is why we expect institutions to keep evaluating the effects of their own behaviour and culture and to aim for ongoing improvements in this area.

This is not to say that DNB prescribes one particular culture. Apart from the fact that culture is primarily the responsibility of the board and the institution, prescribing a single culture is undesirable for another reason. A healthy and stable market benefits most by diversity, not only where business models and strategies are concerned, but also in terms of corporate culture. In fact, we believe that a well-developed culture can sharpen an organisation’s competitive edge. From this perspective, too, we urge institutions to devote more attention to behaviour and culture.

However, DNB does not take a strictly neutral view to culture. We will act decisively against evidence of a culture that induces irresponsible or unsound behaviour. Every culture should contribute to sustained financial soundness and integrity.

This brochure

This brochure informs you about the changes that we believe are ahead and the findings from our assessments that support our views. By way of background, we will depict the developments that supervision of behaviour and culture has seen and the effects that this form of supervision has had to date. In the Netherlands we have been cooperating with the Netherlands Authority for the Financial Markets (AFM) for some time. We hope – and are seeking to achieve – that supervision of behaviour and culture will gain support among our fellow supervisory authorities abroad. For this purpose, DNB will host a conference for its international peer supervisors at the end of September 2015. The objective of the conference is to share experiences and to explain our approach to supervision of behaviour and culture. Especially for this occasion, we have compiled a book entitled “Supervision of Behaviour and Culture” (DNB, 2015).
Principles of supervision of behaviour and culture

Supervision of behaviour and culture is based on the following (evidence-based) assumptions.

1. In order to prevent future crises, we need to do more than tighten up rules and legislation.

2. Public trust in financial institutions and financial stability are related.

3. Board members’ behaviour and decision-making largely determines the culture and performance of financial institutions.

4. Financial institutions are responsible for their own behaviour and culture. DNB does not take on the directors’ position in this respect either.

5. Behaviour and culture are an integral part of operational management: effective management is only feasible if organisational structure and culture go hand in hand.

6. There is no blueprint for an “ideal” culture. Every culture may, however, give rise to risks - supervision is about identifying and managing these risks.

7. Supervision of behaviour and culture applies to all groups in an organisation, i.e. not only to the executive management.
What still needs to be done?

Without doubt, the financial sector saw turbulent times these past few years, also in the area of behaviour and culture. An enormous effort has been made to underpin risk management and careful decision-making, and to put customers’ interests first. There is a broadly shared awareness that devoting attention to behaviour and culture is both inevitable and necessary.

Nevertheless, we believe that the transformation has not yet been finished. DNB expects institutions to step up and enhance the initiated changes. Management and supervisory boards must become more aware of their personal interactions and the effects that these have. In addition, they should make an extra effort to embed the achieved organisational and cultural changes. Too often, we see that financial institutions are reluctant to effectuate changes all the way to the core of their business operations and culture. This creates the risk that changes remain instrumental or superficial and consequently do not lead to sustainable and genuinely different behaviour. Knowing that changes in behaviour and culture take a lot of time and attention, we want to call on institutions operating in the financial sector to accelerate the speed of change, and to enter into an ongoing public dialogue on the subject. Indeed, trust is an important precondition for adequate functioning of financial institutions. The public must be convinced that the changes have filtered down to the very core of institutions. If this fails to happen, trust in financial institutions will not recover, and the risks that went with the pre-crisis corporate culture will continue to exist.
No less than 34 of the 54 assessments performed by DNB brought to light fundamental risks in the area of behaviour and culture. In 63% of all cases examined, the organisation was required to intervene in the short and medium term. In the vast majority of cases, the institutions have actually made these interventions. Below you will find a short summary of the main conclusions from our assessments.

Leadership

DNB’s supervisory assessments have shown that executive and supervisory directors recognise the importance of behaviour and culture. At the same time, their actions do not always culminate in the desired changes in behaviour and culture. Assessments and interviews have also shown that:

- Management boards on the whole do not have sufficient expertise in the area of behaviour and culture: there is still too much emphasis on content-based leadership.
- The intention behind a desired change is not always convincing.
- The proposed measures are not always sufficiently drastic and are not sufficiently implemented, meaning that the envisaged behavioural change fails to materialise.
- Executive directors do not sufficiently abide by the values that they endorsed themselves.

Example of ineffective behaviour

An executive director informs us of the implementation of a new way of working that puts customers first. To our question how the organisation plans to implement the change he simply answers: "this is what needs to be done and that is why our staff will do it". As in other examples, we noticed that executive directors often have no well-defined vision of how they may change their staff’s individual and group behaviour. Changes related to behaviour and culture are wide-ranging and complex, however. They demand a multi-sided approach, based on an unambiguous vision that does justice to the complexity of change, and that is visibly endorsed by the management board.
Decision-making

We found that management boards in financial institutions do not always give due weight to the interests of stakeholders when making decisions. Important risks are also often overlooked, they are not discussed in sufficient detail, or decisions are not challenged. This means that there is likelihood of important information not being considered in the decision-making process, or of decision makers sticking to the preferred solution that presented itself early on in the decision-making process. This detracts from the quality and the degree of acceptance of these decisions.

Group dynamics

We often find a tendency towards consensus and optimism in organisations. The perception may emerge within boards or parts of the organisation that dissenting opinions are not appreciated. Consequently, these opinions are hesitantly put on the table or are not presented at all. This brings the risk that individual expertise and knowledge is not used to its full extent to influence the group decision positively.
Detailed findings

The table below gives a non-comprehensive summary of the findings that emerged from our assessments. Some of these findings are supplementary to those published in our 2013 brochure “Leading by example”. For each example, we have listed the concomitant risks, and the appropriate risk-mitigating behaviour.
## Table 1: Detailed findings

<table>
<thead>
<tr>
<th>Findings</th>
<th>Risks</th>
<th>Good examples</th>
<th>Key words</th>
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<tbody>
<tr>
<td>Poor ownership of behaviour and culture</td>
<td>The board loses credibility and changes are unsuccessful.</td>
<td>Board members who assume responsibility for successful implementation of a cultural or other change and lead by example.</td>
<td>Leadership, Capacity for change</td>
</tr>
<tr>
<td>Interests of stakeholders are hardly identified, weighed and considered</td>
<td>Decisions that do not incorporate stakeholder interests to a sufficient extent. These decisions are not supported, stakeholders do not understand them, and the organisation is likely to come into conflict with its stakeholders.</td>
<td>A management board’s decision-making process has a large degree of constructive conflict. Individual board members contribute their own views and those of the business units that they represent in a constructive way, and demand attention for these views when the pros and cons of different interests are considered.</td>
<td>Decision-making</td>
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<tr>
<td>Poor awareness of own strategy and core values.</td>
<td>The institution is unpredictable and unreliable to stakeholders and is prone to taking excessively risky decisions.</td>
<td>Organisations that are able to bring their core values across by giving concise and meaningful guidance. This guidance is easy to include in staff members’ day-to-day work, meaning that decisions are managed throughout the organisation.</td>
<td>Decision-making, Leadership</td>
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<td>Tendency towards consensus and excessive optimism</td>
<td>Risks are not sufficiently acknowledged in the decision-making process. As problems are only addressed at a late stage, they escalate and are more difficult to solve.</td>
<td>A management board that carefully weighs opportunities and risks. The board verifies that all risks are discussed and asks external experts for support in doing so.</td>
<td>Decision-making, Group dynamics</td>
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<td>Decisions made exclusively on the basis of procedures and models.</td>
<td>Decisions are taken on autopilot, without personal judgement being included. This carries the risk of excessive risk taking and denial of dilemmas.</td>
<td>Awareness that reality is more complex than models can depict. Organisations that know how to get their staff to commit to their values and targets, enabling them to make considerations that benefit the interests of the organisation and its stakeholders as much as possible.</td>
<td>Decision-making</td>
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### Continue table 1: Detailed findings

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<th>Good examples</th>
<th>Key words</th>
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<td>Little knowledge, expertise and/or skills in the area of behaviour and culture</td>
<td>Changes do not have the desired effect as the underlying vision is not translated into tangible behaviour. The vision does not come alive for many people in the organisation.</td>
<td>The organisation recruits senior managers who have knowledge of and experience in the area of change management. These staff members are appointed to positions that give them the opportunity to make a meaningful contribution.</td>
<td>Leadership, Capacity for change</td>
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<td>Leadership and chairmanship too much focused on content</td>
<td>Others are discouraged from expressing their opinions freely. Changes are potentially ineffective, the top has insufficient influence and a culture of enforcement, rather than one of learning and development emerges.</td>
<td>Leader who knows how to balance content-based leadership and people oriented leadership. This means that the leader is able to act as the situation demands. Establishing cultural change for instance demands a great deal of people oriented leadership.</td>
<td>Communication, Leadership, Capacity for change</td>
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<td>Little feedback on non-content-related aspects.</td>
<td>A culture does not change significantly and individual staff members are not enabled to learn to a sufficient extent.</td>
<td>Staff and management hold each other to account on aspects such as personal interaction. This is done in a constructive manner, with respect and the common goal, an effective organisation, always being the leading themes.</td>
<td>Communication, Group dynamics</td>
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<td>Insular sub-culture</td>
<td>Boards are primarily on the look-out for new members that are likely to adapt themselves to the prevailing culture. Within the prevailing subculture, mutual behaviour is primarily confirmed and not sufficiently criticised. This creates a gap between board, staff, customers and other stakeholders.</td>
<td>A financial institution that consciously recruits a senior executive from outside its own sector. This brings in a fresh perspective, which dares to question the board’s basic assumptions. This sets the organisational culture in motion, and the quality of decisions will improve. Different perspectives are effectively managed to prevent miscommunication and friction between board members.</td>
<td>Group dynamics</td>
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<td>Risks</td>
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<td>Poor reflective abilities and little reflective learning.</td>
<td>Institutions and their boards and staff do not learn enough from their own experiences. They do not learn from previous mistakes, and hang on to ineffective approaches too long.</td>
<td>A management board that after each meeting evaluates the process followed during the meeting. Questions that need to be answered include: were the dynamics between the board members conducive to effective discussions and decision-making? Was the contribution of the individual members especially effective or was it the opposite? How did the members act, what was their attitude?</td>
<td>Communication Group dynamics Leadership Capacity for change</td>
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<tr>
<td>Little attention for implementation and embedding of change.</td>
<td>Ideas get stranded and are not put into practice. Staff is demotivated and results are missed as the organisation fails to implement change effectively.</td>
<td>An institution that changes gradually in a well-considered direction without dictating the exact route. Progress is frequently evaluated and redirections are made if necessary.</td>
<td>Capacity for change</td>
</tr>
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<td>Few or no priorities in change initiatives</td>
<td>Changes are not carried through due to lack of priorities, and staff and stakeholders are unclear about the organisation’s strategy and intentions. Staff members eventually set their own priorities, and the organisation fails to achieve its objectives.</td>
<td>An organisation formulates clear priorities for change, and is able to implement, monitor, and adjust the process as it concentrates on a small number of top priorities, rather than a large number of changes.</td>
<td>Capacity for change</td>
</tr>
<tr>
<td>Complexity hinders effective management</td>
<td>The organisation is difficult to manage, or cannot be managed at all. The board loses its grip on what’s going on in the organisation.</td>
<td>An organisation that sets up small units, and passes responsibility on to these units as much as possible. This shortens the lines of responsibility and management and top management is more aware of and has grip on the situation.</td>
<td>Communication Group-dynamics Leadership</td>
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Effects of supervision of behaviour and culture

DNB uses different instruments to monitor supervised institutions, e.g. follow-up interviews and on-site assessments. If necessary, institutions are monitored over longer periods of time. Based on the information obtained, we see that institutions increasingly take action as a result of behaviour and culture assessments and that these actions are often effective. Some examples:

- Supervisory boards increasingly hold management boards accountable for the organisation’s behaviour and culture.
- Supervisory boards also increasingly address sensitive issues directly and take action if the institution’s dynamics are ineffective.
- Measures are taken to reinforce existing structures and processes, for instance by organising constructive challenge more explicitly. As a result, interests are discussed more in detail and decision-making processes are more robust than before.
- Institutions are reinforcing internal constructive challenge. This is done by involving control functions like compliance or risk management more and at an earlier stage and by reinforcing the roles played by independent board members, and the second and third lines. This enables them to have a meaningful influence on decision-making.
- Changes are aimed more at embedding cultural change than on making plans.
- Increasingly often, cultural change is considered to be the responsibility of the management rather than the HR department.
- In some cases, supervision of behaviour and culture has structural and staffing consequences, which have also resulted in the departure of board members.
- Attention for behaviour and culture has visibly grown. Our first assessments often met with scepticism about this perspective on supervision. Nowadays behaviour and culture is recognised as a prudential and integrity risk, making it the responsibility of the organisation and its senior management.

An important additional effect of supervision of behaviour and culture is that we as supervisors are getting a consistent perspective on the causes underlying various supervision incidents at the institutions that we supervise. This has given us more options for intervention, and our interventions have become more effective.
Development of supervision of behaviour and culture

As said in the introduction to this brochure, after 2008 we saw a growing awareness that the crisis had partly been caused by clearly identifiable human behaviour, and that new rules and regulations – although necessary in many areas – would not provide sufficient guarantees that history would be prevented from repeating itself. This realisation led us to publish our policy vision “The seven elements of ethical culture” in November 2009. Building on this document, we further expanded our supervision of behaviour and culture in 2010.

Supervision of behaviour and culture was assigned to a dedicated Expert Centre in 2011. Professionals representing various disciplines were recruited. These include governance, risk, change management, and organisational psychology. Since 2011, thematic assessments - using newly developed instruments each time – have been performed into the following topics.

- Decision-making
- Board effectiveness
- Capacity for change (together with the AFM)
- Risk culture
- Search for yield
- Root causes of supervision problems

To date, 54 assessments have been held and completed into these six topics (see the table below). As a supplement to our long-term monitoring, we performed additional assessments at nine institutions in order to gauge the effects of our earlier assessments, or because we received signals of risks emerging on one of the other topics.

Table 2: Assessments of behaviour and culture, 2010 to July 2015

<table>
<thead>
<tr>
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<th>Number of assessments</th>
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<tbody>
<tr>
<td>Banks</td>
<td>20</td>
</tr>
<tr>
<td>Insurance companies</td>
<td>17</td>
</tr>
<tr>
<td>Pension funds</td>
<td>11</td>
</tr>
<tr>
<td>Trust offices</td>
<td>6</td>
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