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Model Governance Versus Normalized Policy Deviance

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Model governance is a formalized decision framework designed to help ensure that models accomplish their intended purpose. But simply establishing and communicating the model governance framework is merely the beginning of governance because of two cruel truths of organizational life:

1. No management communication is 100 percent effective, and

2. Management's intentions will never be 100 percent implemented.

There are a number of reasons for item number two of this list. They include such things as time pressure, lack of understanding, conflicting goals, organizational culture and organizational politics. In any large organization there will be numerous instances where actual policies, practices and procedures deviate from formal policies, practices and procedures. In some cases, these deviations will be flagrant.

Through the standard pathway of socialization, institutionalization and rationalization, these policy deviances become accepted as normal—in some cases even being considered best practices.

One of the challenges of effective model governance is identifying and addressing such deviations before they cause material model failure.

A FEW REFERENCES

The first reference is Dan Luu's blog.[1] This blog is what got me started thinking about the topic of policy deviance. The second reference is a scholarly article by Diane Vaughan from the *Annual Review of Sociology*, "The Dark Side of Organizations: Mistake, Misconduct, and Disaster."[2] This article discusses policy deviance in a general way applicable to all organizations.

Finally, there is John Banja's article, "The Normalization of Deviance in Healthcare Delivery."[3] His article helped me to articulate many of my own ideas.

AN EXAMPLE OF DISASTROUS CHRONIC POLICY DEVIANCE

Banja gives the following example of a catastrophic series of policy deviations in the operating room:

- The surgeon requests the anesthesiologist turn off the ventilator so he can take an x-ray.

- The anesthesiologist either forgets to turn the ventilator back on, or else he mistakenly thought he had turned it back on.

- The ventilator had been programmed to go into indefinite suspend mode, so that no alarms would go off—possibly because the operating room staff found the constant beeping to be irritating and distracting.

- The patient went without oxygen so long that she went into a vegetative state, and died 11 days later.

Anyone who has had much experience in model management can easily analogize this example to insurance models. Some model fail-safe is disabled because it is "never needed" and enabling it causes the model to operate too slowly. Through institutionalization of the disabled fail-safe, the model operators forget about the scenarios for which the fail-safe was designed, so that when one of these scenarios occurs, the model fails—potentially in some disastrous fashion.

Banja points out that many disasters have the following common elements:

- A long incubation period
- Chronic rule violations
- Unnoticed accumulation of discrepant events
- Cultural beliefs about the unlikelihood of hazards

Several observations regarding model governance can be drawn from these common elements:

- **The attitude of, "If it ain't broke, don't fix it" has no place in effective model governance.** Just because a model has not experienced a failure doesn't mean it ain't broke. Some models are disasters waiting to happen. These models are often apparent to knowledgeable reviewers who are not under the spell of socialization, institutionalization and rationalization of policy deviations.

- **The extent and history of policy deviations should be a primary red flag.** A single deviation from model policy is unlikely to cause model failure. However, at some point, the accumulation of deviations combined with a casual attitude toward compliance are often indicators that the model may be ready to go off the rails.

- **Effective governance must address culture.** Culture is all of the unwritten and unspoken rules of behavior inside the organization. Cultural rules are learned before formal rules and are enforced more completely than formal rules. A culture that forbids criticism of a fellow team member is one in which policy deviance can thrive. A culture in which you lose face if you admit there's a problem is one in which policy deviance can thrive. A culture in which model hygiene is perceived as a low-value activity is one in which policy deviations can thrive. Effective governance must uncover such cultural norms so that model compliance and model hygiene are recognized as high-value activities.

REASONS FLAGRANT DEVIATIONS BECOME NORMALIZED

Banja identifies seven avenues by which policy deviations come to be considered normal practice. He acknowledges that the first appears to be the most common reason for normalization.

1. **The formal policies are perceived as inefficient or unresponsive to real problems.** Employees often view rules from on high as being out of touch with the reality of their jobs. Because model operators are more vested in the process of running the model (as opposed to mitigating risk), it is usually easy to create workarounds to formal requirements.

2. **Awareness of model governance standards is imperfect and unevenly distributed through the organization.** This problem is especially true for new employees in organizations that have extensive formal guidance. In fact, the more formal guidance there is, the more likely there will be policy deviations.

3. **Work procedures are sometimes disruptive.** Complex work often results in varying and unpredictable work requirements. Dealing with these requirements may disrupt typical work behavior such that policy compliance is ignored. This is especially true when new products, new processes or new computer systems are installed.

4. **The deviation is viewed as adding value to the organization.** Policy deviations often occur as solutions to immediate problems. When this happens, employees view the deviation as a good thing that adds value to the organization, rather than as a bad thing that could cause serious problems.

5. **Employees see policies as applicable only to others.** Employees often perceive themselves as acting correctly without the policy; therefore, the policy does not apply to them. This is true even when the employee's perceptions have no basis in reality.

> Many policy deviations are viewed by employees as being beneficial to the organization because they are solutions to some particular set of everyday problems.

6. **Employees are afraid to speak up.** If employees refuse to speak up when they observe policy deviations, normalization is encouraged. There are a number of reasons why employees might not speak up. These include lack of assertiveness, fear of retaliation, concern for undercutting a working relationship and a lack of confidence that speaking up will do any good.

7. **Managers understate problems or do not report them at all.** In an organization where politics results in loss of face if a manager admits to problems, identified policy deviations will be soft-pedaled as they are sent up to higher echelons. In addition, any identified problem whose remediation is perceived as a threat to normal work flow might not be sent up the ladder at all. This is especially true when there is an accumulated backlog of policy deviations that must be addressed.

WAYS TO PREVENT DEVIATIONS FROM BECOMING NORMALIZED

Banja also identifies some ways to prevent deviations.

Increase Management's Sensitivity to Early Indications of Deviance

Deviations from model policies and procedures occur more frequently than we like to believe. It is important to sensitize employees to the importance of compliance so that they view deviations as problems.

Resist the Urge to be Optimistic

For many model owners, the calculus of compliance is that addressing a policy deviance results in immediate and certain pain and delay, while ignoring a policy deviance has only a small likelihood of resulting in some hypothetical model failure at some point in the future.

While it is true that a single deviation has a tiny probability of causing model failure, deviations are not rare events. If you find one, you haven't found them all. Allowing any model deviation to remain sets the stage for socialization of deviance.

Teach Employees How to Raise Compliance Issues Even Though This is Uncomfortable

Confronting a model owner or model operator with deviations from formal requirements can be highly stressful. Many employees will avoid this discussion, if at all possible. This is especially true in organizational cultures that value teamwork and consensus.

This is not an area where actuaries typically have expertise, so assistance from the appropriate organizational department—typically human resources—will be necessary.

Provide Employees Safe Ways of Speaking up

There need to be policies that specify when employees are expected to speak up. These policies must promise protection for speaking up. Training sessions need to be conducted throughout the organization.

This is an area where most companies experience difficulties. Both culture and politics usually militate against speaking up, no matter what policies are promulgated. In addition, encouraging employees to speak up can create its own set of problems.

Oversight and Monitoring Must be Continuous

Because of the ease with which policy deviations can occur and become normalized, effective governance must make provision for continuous monitoring. A "once and done" mentality will not result in any change in pathological culture or politics.

Although not discussed by Banja, another important consideration for companies is the ability to perform objective reviews of failures. The ability to sift through the evidence and identify weaknesses is an important organization skill that allows companies to learn from their mistakes. Too many companies have a culture that looks for people to blame for the failures that occur. This approach not only prevents learning from failures; it fails to address the underlying problems.

THE ETHICAL DIMENSION

Most policy deviations are not due to deliberate insubordination or other unethical intent. Most people are virtuous in abstract, but run into ethical uncertainty when competing goals jostle against each other. In fact, many policy deviations are viewed by employees as being beneficial to the organization because they are solutions to some particular set of everyday problems. The deviations allow the employee or team to accomplish its responsibilities, usually with no apparent effect on model integrity.

Effective model governance emphasizes compliance by communicating the importance of model hygiene and the value that it has for the organization. In addition, effective governance provides incentives for employees to value compliance.

Because there is seldom unethical intent in policy deviance, and because model failures are often the result of systemic failure rather than from isolated behavior, organizations must take care that punitive actions are proportional to culpability.

A FINAL CRUEL TRUTH

Effective model governance is neither easy nor cheap. Implementation will often require trade-offs with other desirable organizational activities. Such trade-offs will never have universal support. If history is any guide, most companies will not implement effective model governance until they have suffered some notable model disaster.

CONCLUSION

It is naive to believe that simply promulgating an optimized decision framework with carefully crafted rules and procedures will result in effective model governance. Effective governance requires a sympathetic understanding of how employees perform their tasks and responsibilities, how they assimilate management requirements and directives, and how deviations from the requirements occur in even the best-intentioned employees.

Effective model governance requires the following:

- Implementation of practices that prevent the normalization of policy deviations, which includes education as well as addressing cultural and political norms within the organization

- Functioning feedback loops that allow the organization to learn from mistakes, especially disastrous mistakes

- Continuous oversight and compliance review

- Formal processes for correcting deviations ■

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ENDNOTES

1 The blog can be found at *https://danluu.com/*. The particular post that started me thinking about this topic is *danluu.com/wat*.

2 Vaughan, Diane. 1999. The Dark Side of Organizations: Mistake, Misconduct, and Disaster. *Annual Review of Sociology* 25:271–305, *http://www.jstor.org/stable/223506?seq=1#page_scan_tab_contents*.

3 Banja, John. 2010. The Normalization of Deviance in Healthcare Delivery. *Business Horizons* 53, no. 2: 139, *https://www.ncbi.nlm.nih.gov/pmc/articles/PMC2821100/*.