BTRM

The Certificate of Bank Treasury Risk Management

What the 2023 bank failures tell us about making “risk management” real...

Nubank Risk Tribe presentation

Thought Leadership Series #12

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Faculty BTRM

16th April 2024

What the 2023 bank failures tell us about making “risk management” real…

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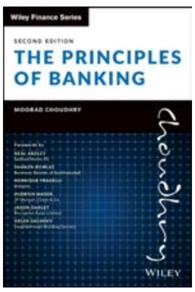
Agenda

- The traditional “enterprise risk management” concept
- Risk strategy
- Embedding risk management processes into the firm’s daily practice through an effective risk culture
- Team building
- What 2023 bank failures tell us about risk culture
  - Silicon Valley Bank and their time-serving CEO
  - Credit Suisse: a case study in the wrong culture
- How to make risk management “real”
  - Embed the right risk culture

"Risk culture"

- The agenda started with governance and ERM
- But before we've even started, an interlude….

The Principles of Banking, 2nd Edition (Wiley 2023) ….
Extract from the "Afterword" (pages 771-773)



From the First Edition:

"The risk management principles we have discussed in this book are identical whichever way one looks at them: be it from a shareholder-value perspective, hedging or fair-value perspective, regulatory requirement perspective or societal well-being perspective. It is important for bank management to incorporate them into their strategy and practice, even if they think that other banks are ignoring them."

And from the Second Edition:

"These words remain relevant in 2022, and I daresay will be in 2032 or 2122. But what I have learned since the first edition was published is this: it is easy, very easy, to ***write*** *these things in a Word or PowerPoint file. It is even easier to say them, and easier still to stand up and present them to an audience, because no-one will disagree with you. The challenge lies in* ***actually doing them****. Making them happen. Making them* ***reality****. That is the problem that bank managers face – how to make real, in practice and in their day-to- day business, what is written down in policy statements and governance frameworks."*

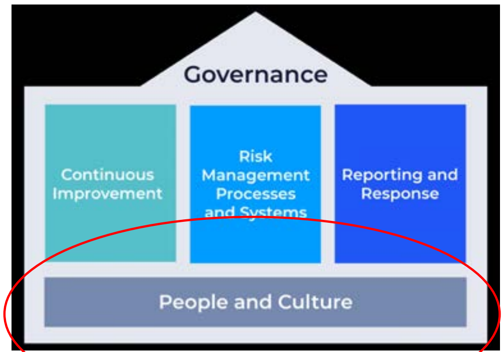
This is "Risk Culture": actually doing what you say to your stakeholders you will be doing…

So what are the "things" that we say we're doing?

Enterprise Risk Management

ERM…

- Protecht Group uses the following diagram to illustrate the ERM framework
- It describes the constituent parts as:
  - ***The Roof – Governance.*** *This covers the mechanisms and structures that provide overall governance of ERM, including Roles, Responsibilities of Committees, the "Three Lines" model, and Risk Appetite*
  - ***The Foundations - People and Culture*** So if we don't get this part right, the rest is effectively irrelevant!
  - ***The Rooms. Risk Management Processes and Systems*** *This covers the core risk management processes, including but not limited to, Risk Assessment, Risk Metrics, Incident Management and Compliance.*
  - ***The Right Hand Wall – Reporting and Response.*** *This includes Escalations and workflows*
  - ***The Left Hand Wall – Continuous Improvement****. This covers Issues and Actions Management, "Root Cause Analysis" and Risk Treatment*



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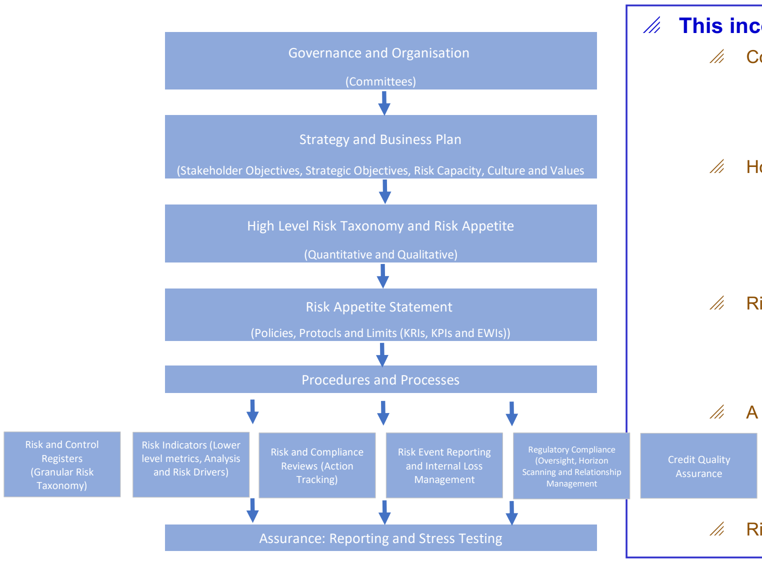
ERM in banks

- In most jurisdictions, banks are required to develop and implement an "Enterprise Wide Risk Management" (ERM) framework that is approved by the Board of Directors
- Author's definition: *In essence, for a bank this means having a risk management framework (RMF) that enables the definition, measurement, monitoring, mitigation and management to calibrated risk appetites of all the risk exposures that it faces in the ordinary course of business, as well as exposures that might impact it during any unforeseen stress event.*
- The RMF ideally should
  - Establish risk tolerance and risk limits for all risk types, ensuring they are embedded in the business strategy and day-to-day operating processes;
  - Define the organisational structures and tools that will be applied to identify, analyse, evaluate, manage and monitor all risk types;
  - Enable provision of risk data aggregation and reporting to specific responsible persons

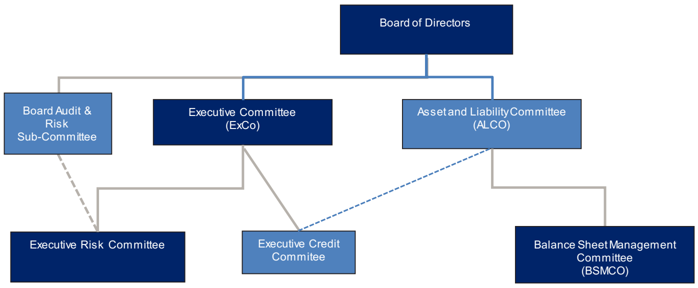
What does a good ERM framework look like?



- **This incorporates:**
  - Committee structure and authority
    - Board and Board Risk + ALCO Committees
    - Mandate + delegated authorities
  - Holistic approach
    - Risk Management philosophy and
    - key principles
    - Link to strategic planning capital + funding frameworks
  - Risk Culture, Values and Behaviours
    - "Tone from the top"
    - Transparency, reporting and disclosure
  - A Risk Appetite Statement
    - All Key Risks identified and defined
    - Quantitative Risk Bearing capacity
    - Risk Appetite and firm Limits
  - Risk Framework + Key Risk Policies

A recommended Board, BRC, Exco and ALCO operating model

- The recommended Board, BRC, Exco and ALCO operating model: reflects paramount importance of the ALCO in the overall ERM and prudential regulation compliance process



***"The Principles of Banking*, 2nd edition (2023), Figure 9.7**

Risk management framework

- The RMF is observed and implemented via the following principles:
  - Governance is maintained through the effective delegation of authority from the Board down through the committee and management hierarchy to specific named individuals;
  - Risk management supports the safe delivery of the bank's strategic plan and objectives;
  - Risk management is based on the Three / Four Lines of Defence model, in which the business management owns and reports on the risks assumed throughout the bank and is responsible for ensuring that these are managed and controlled on a day-to-day basis;
  - The Board and business management are engaged in and promote a culture in which risks are identified, assessed and reported in an open, transparent and objective manner;
  - ***The Risk Appetite Statement (and risk limits) are embedded in the BUs and adhered to***
  - 2LoD (the Risk function) is independent of the businesses and provides both oversight and challenge; it also provides support and advice on the management of risk across the business;

Risk strategy

- Sound risk management is at the heart of a bank's strategic objectives, both as an end in itself and to facilitate the achievement of the bank's business strategic objectives. The ultimate aim is to protect the bank's long-term viability, which ***must include*** producing sustainable medium- to long-term revenue streams.
- A bank's strategy is to concentrate on customer lending and deposit-taking activities, and only in those areas ***where it has genuine subject matter expertise***, both in the 1st and 2nd Line of Defence (LoD). It will also originate only those financial products in which it has the necessary operational capacity, systems and infrastructure to manage effectively and monitor the products throughout their life cycle.
- The Board's risk strategy is reflected in its Risk Appetite Statement (RAS) document. This is supported by a set of appropriate key risk indicators (KRIs) and early warning indicators (EWIs). Together, these describe the amount of each risk type that the bank is willing to take in pursuit of its strategic objectives.

Risk strategy…

- Risk strategy includes that the bank has an established RMF in place which ensures that it :
  - operates with integrity within the marketplace.
  - ***operates within Board approved risk appetite***; and
  - complies with regulatory requirements and meets the expectations of the [national supervision authority] PRA and FCA
  - has in place a Board and executive that understands the risk exposures that the bank faces and has the requisite technical expertise to manages these exposures during times of market stress
- While at any time the RMF should be fit for purpose ***today***, the risk management of any entity will change over a period in line with the evolution of its risks.
- This highlights the importance of establishing a ***risk management strategy***, which will be subject to regular review, to ensure that the bank maintains an appropriate approach to risk management at all times

Risk strategy: Building in adaptability and resilience

- Risk culture and governance
  - At Board level risk management and control is given adequate time….Board and its members take their regulatory and fiduciary responsibilities seriously
  - Ensure at Board level there is an appetite to ensure that the risk framework "front runs" the business growth and agenda
  - At Executive level the picture should be similar, with the "C-suite" reflecting the same approach
  - Subject the risk culture to significant internal and external scrutiny, formally via Internal Audit and by external independent review

Updating the risk register

- An effective risk register is one that identifies risk types ***before*** the bank is actually exposed to them
- This implies the powers of a clairvoyant…
- …but compared to what our register might have included 10 years ago, today we would expect to add a few more…

- ***EXAMPLE:*** Extract of updated risk register showing latest additional risk types and selection of mitigating actions….
- Clear individual ownership and appropriate governance committee noted
- ***This needs to be an at-least semi-annual review process***
- And today…
- "SOCIAL MEDIA RISK"…
  - Risk of negative and/or fake news on social media going viral and triggering an instant bank run…
  - …with funds accessed via smartphones instantly

Risk Area	Action Proposed	Responsible	Committee
Regulatory Reporting	Define regulatory reporting as a discreet risk appetite, including a risk appetite statement limits and calibration.	CRO	BRC
Third Party	Train new technology analyst resource in 3rd party management	CTO	Exec
Operational Resilience	Ensure BCP training also includes operational resilience training	CTO	ERC
Cyber	Assess the bank against CQUEST	CTO	Board
Operational Resilience	Develop the operational resilience database and dashboard	CTO	Exec
Data	Information Security Manager to become Deputy Data Protection Officer (DDPO)	DPO	Exec
Conduct	Review and update Conduct Risk Dashboard and reporting once MI starts following from Deposits and Lending	CRO	ERC
Financial Crime	Implementation of TruNarrative AML system	CCO	ERC
Climate Change	Clear plan for 'green' product development	CCO	ExCo
Climate Change	Develop the capability for financial risk assessment and scenario testing which will include consideration buying in of benchmarking data	CFO	BRC
Data	Undertake an internal review to ensure that all personal data is stored securely on the network with no data held on local devices	CTO	ERC
Conduct	Update customer harm risk assessment for products and services	CRO	BRC
Climate Change	Customer Engagement plan on emissions impact and transitioning to net zero	CCO	BRC
Cyber	Deliver a secure development framework	CTO	ERC
Climate Change	Undertake a review of our position against emerging best practice	CCO	BRC
Cyber	Commission a 2LoD review of the cyber risk and control framework	CRO	ERC

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Embedding RAS throughout the bank

- **Articulating and communicating the bank's risk appetite**
- The RAS needs to be articulated in a manner that employees will understand and can use to measure risk against. This can be achieved via the following methods:
  - **The board-level RAS**
  - **The Risk Appetite Policy Statement**, part of the RMF and the ERM framework
  - A series of **"Mini" RAS** for use in Group or multi-entity banking groups, for use at subsidiary/divisional level. These are They are tailored statements for each subsidiary/division based on standardised group RAS.
  - **Code of Conduct.** The code of conduct should clearly articulate boundaries for staff behaviour, linked to risk appetite.
    - And be plain language avoiding "platitudes"
  - **Key Risk Indicators (KRIs).** The specific metrics (one or more for each risk type in the risk register) and managed to calibrated quantitative limits
  - **Risk Matrices.** The traditional risk matrix, where risk is measured using a qualitative assessment of likelihood and consequence, is often used as a basis of setting risk boundaries and evaluating Risk Appetite:
  - **Policies, Standards and Guidelines.** Internal policies, standards and guidelines are a common way to communicate risk appetite in a meaningful way so that staff understand the boundaries within which they need to operate.

Communicating the overall risk position

- As part of embedding and operationalising the RAS, there are a number of high level summary risk dashboards that can be used in banks
- There is more than one solution...
- …ideally, the reporting mechanism will be
  - Succinct
  - Accessible
  - Give the complete picture in one or two slides
  - Be forward looking
- We show the author's own high-level risk dashboard for senior executive distribution (see next slide) >>>
  - "The balance sheet is everything!"
  - --RBS Group Treasurer to the author, 2010

Risk Culture

Risk culture

- The “right” Risk culture is essential if a bank is to ensure that “risk management” is “real”….
- Risk culture has been defined in a number of ways and there are indeed a number of ways of looking at it
- Speaking personally, the author would simply define it as always…
  - “Doing the right thing”
  - “Do good work”
- …and leave it at that. However there is much formal literature written on this topic so we need to cover it in more than one sentence!
- To us, risk culture is part of the firm’s culture, so let’s define that first
  - A firm’s “culture” is the beliefs and attitudes about something that people in a particular group or organisation share, and/or
  - a system of shared values (that define what is important) and norms that define appropriate attitudes and behaviours for organisational members (how to feel and behave)
- There are some common beliefs and traits that run thru these…

Risk culture…

- **What culture is**
  - Culture is made up of beliefs, values, expectations, practices and assumptions. It drives, and is driven by, the way the firm's employees think.
- **What culture is driven by:**
  - Culture is driven and influenced by many factors including, but not limited to:
    - Behaviours of our leaders "tone from the top",
    - Existing accepted practices within the organisation
    - Culture of our people brought in from outside of the organisation,
    - Practiced and lived Vision, Mission and Ethos of the organisation
- **What culture leads to:** Culture affects the way people and groups make decisions and interact with each other, with clients, and with all stakeholders
- The author will stick to one conduct mantra that sums up "culture":
  - ***"Ethics is doing the right thing when no-one is looking"***

Risk Culture: a great (obscure!) Case Study

- ***PRA fines MS Amlin Underwriting Limited £9,695,000 for failings in its governance, controls and risk management***
- https://www.bankofengland.co.uk/news/2022/october/pra-fines-ms-amlin-underwriting-limited
  - 18th October 2022
- In the Executive Summary the PRA say that MSAUL failed in its risk management because
  - i) there wasn't a strong risk culture;
  - ii) the 1st and 2nd lines of defence were "blurred";
  - iii) they failed to remediate deficiencies identified.
- The PRA goes on to say the firm failed to organise and control their affairs responsibly and effectively because i) underwriting governance was fragmented; ii) underwriting was presented at such a high level the Board could not effectively challenge it; iii) MI was inadequate.
- **Lessons for us all speak to having the right "Risk Culture" in the bank**
  - **1- Policies only protect you if follow the policies.**
  - **2- having 3LoD only works if you act on 2LoD and 3LoD findings**

Team building

Relevance to risk management

Well-led teams are part of a good risk culture

- Well functioning teams assist an effective risk culture
- A team that works well together will see a common, shared objective in their endeavour – being part of a well-managed bank – and this generates a sound risk culture
- The key to well-functioning teams is effective leadership….

Team building thru leadership

FEATURE

LESSONS IN LEADERSHIP

IN HIS ROLES AS A PROFESSOR OF FINANCE AT BRUNEL UNIVERSITY AND A CITY OF LONDON BANKER, PROGRAMME SPONSOR **MOORAD CHOUDHRY** OFTEN ADDRESSES ASPIRING ENTREPRENEURS ON WHAT IT TAKES TO BE A TEAM LEADER. BUT, HE SAYS, HE MAY HAVE TO REWRITE HIS LECTURE NOTES AFTER SEEING AT FIRST HAND HOW NEAL ARDLEY AND NEIL COX LEAD A TEAM OF PLAYERS.

Recently I had the privilege to play in the annual shirt sponsors' match alongside the Dons management team. An XI made up of staff from the shirt sponsors, Sports Interactive, faced an XI led by the Dons management and supplemented by other club commercial sponsors. The game was played in an appropriate spirit, exemplified by Ivor Heller kicking off the match for the management team.

It was all great fun, but for me it was also something of a revelation. My time on the pitch was limited to around 20 minutes in the first half and 25 minutes in the second. But I learnt more about team leadership in those 45 minutes playing alongside Messrs Ardley and Cox than I have during thousands of hours spent in seminars and MBA programmes over the past 24 years in the City.

So here is my eight-point guide to leadership, based on seeing Neal and Neil in action. It can be applied in virtually any walk of life, but it should be required reading for anyone in an office environment aspiring to lead teams – and it's a lot cheaper than an MBA!

1. Treat everyone as equals in the way you speak to them and communicate instructions. Neil Cox didn't vary the way he spoke to individuals in the team, whatever their ability, familiarity or position. He delivered instructions in exactly the same way to everyone. This builds tremendous loyalty and confidence.

2. Lead by example. This is nothing new. The difference was that these two guys *really did it*. They put in the effort and, what's more, it was obvious that they were putting in the effort. This has a tremendous inspirational effect on team members.

3. Provide continuous encouragement. Everyone likes to feel appreciated, both when things are going well and when they are going badly. Ardley and Cox delivered encouragement at every possible opportunity. This makes a big difference.

4. Don't dwell on mistakes, and don't apportion blame. When a player made a mistake, it wasn't dwelt on because the player was aware he had made it. We've done it – let's move on and try again. This is tremendously inspiring and makes everyone try harder.

5. Make everyone feel part of the same team: no cliques, no favourites, no inner circles. Whatever the situation, it is enough that everyone feels part of the same team and that no one person is favoured more than any other. This is a platitude espoused by every office manager in every company; sadly, in nine out of ten offices it just isn't true.

6. Involve everyone, and keep involving them. This follows on from the previous point. One way to inspire people to want to follow you is to involve them: it makes them feel that you believe they'll do a good job. The modern office equivalent of this is "don't micromanage, and learn to delegate". The difference between most corporate managers and the Wimbledon management team was that the latter *really did this*.

7. Trust your subordinates' judgement. It will make them want to do well and inspire them even more. They are there to do a job, and to build a truly effective team one has to accept their answers. A team leader who does this will inspire loyalty. A leader who can't do this needs to rebuild the team. You won't inspire dedication if you always question your team members' judgement.

8. Act so that everyone is aware they have the same objective. This is the easy bit with a football team. There are no individual winners if the team loses. But by applying points 1 to 7 above, Neal Ardley and Neil Cox cover the essentials of team management first. After that, it's up to the players.

People define "leadership" in various ways, but really it boils down to inspiring people to want to follow you. This sponsors' game was just a bit of fun, and a million miles away from the serious business of a professional football match. But character comes across in any situation, and a transparent approach to leadership is tremendously inspiring. Unlike in an office, on a football pitch there is little if any room for artifice and platitudes. It was fantastic for me to see that Neal Ardley and his entire management team possess leadership and motivational skills that should make them not only a success in football, but would also make them ideal team leaders in any business environment. Not that I want them to change profession just yet!

Adapted with permission from "Leadership Lessons from the World of Sport", first published by CNBC at www.cnbc.com/id/100973768 on 20 August 2013.

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The "Total Team" concept*

RBS "Project Bluebird" (2013-14) Treasury Doctrine

- Everyone is involved in all tasks
- No single-person dependencies
- Open, collaborative and challenging environment
- Effective upward and downward delegation
- Supportive, genuine teamworking ethos
- Open access: no cliques, no inner circles, no favourites
- Genuine, straight speaking: no consultant-speak

* "Total football" was the concept developed by Rinus Michels (1928-2005) at Ajax and later at the Dutch national side, described roughly as "every player can play in every position". The analogy to Total Treasury is very approximate ☺

Risk Culture:
"Lessons Learned" in 2023

Case Studies in (Risk) Culture and Competence

Is this a new kind of bank collapse....?

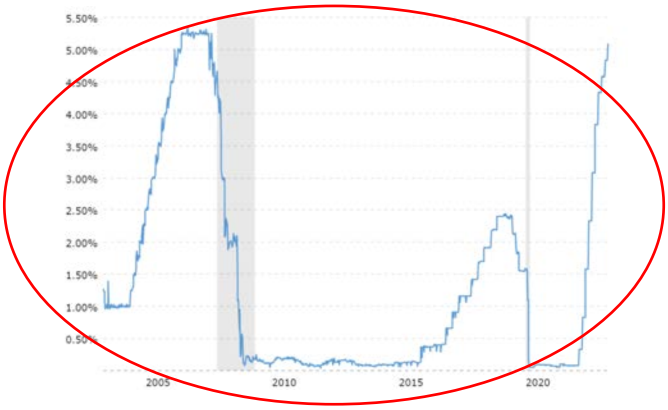
….or did their failure all have something in common?

- *"Do you remember the case, Gregson?"*
- *"No, sir."*
- *"Read it up - you really should.* ***There is nothing new under the sun.*** *It has all been done before."*

  --- Sherlock Holmes, *A Study in Scarlet*, 1887 (Sir Arthur Conan Doyle)

These banks' failure was blamed on the rise in rates…

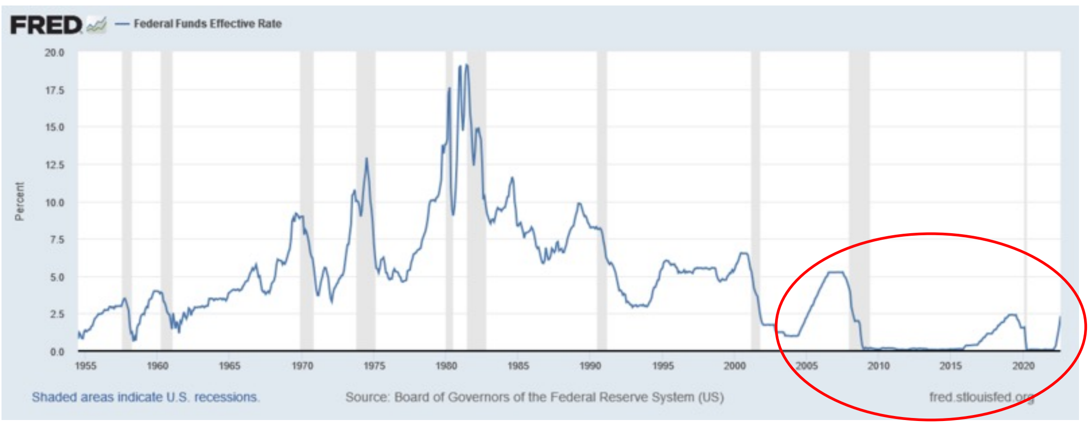
- Media commentators (and some practitioners) suggested the rise was scary and "unprecedented"….
- Fed Funds Rate 2003-2022:



Source: ICAEW 2023

Sigh…..

- Fed Funds rate: 40-, 50- and 60-year history



Source: Wikipedia.

The original sin

- Every bank in the USA (not to mention in UK and EU) had to deal with and manage the rise in interest rates during 2022 and 2023
- The large majority of them didn't go bust!
- The impact of rising rates exposed a flawed funding model at Silicon Valley Bank (as it did at Signature Bank and was shortly to at First Republic Bank)…
- …as well as an inadequate b/s management governance structure (it's up to the ALCO to communicate effectively to the Board, to provide comfort that the b/s is in good shape and resilient to changes in external factors (or not)
- But this requires the ALCO to have some authority and to be taken seriously by Board and C-suite
- (See Appendix for technical points of note regards b/s risk and ALCO governance at SVB)

The culture inculcated by SVB's CEO

- From *The New York Times* (16/5/2023)
  - In his first public remarks since Silicon Valley Bank collapsed, triggering widespread industry turmoil, the lender's former chief executive pointed the finger at pretty much everybody but himself, casting blame on regulators, the media, his board of directors and even the bank's own depositors.
  - "It was bone-deep, down-to-the-marrow stupidity," Senator John Kennedy, Republican of Louisiana, told him.
  - A three-decade SVB veteran, he became chief executive in 2011 and oversaw its rapid growth in the following years.
  - "I worked at a place I truly loved," he said, calling himself "truly sorry" for what happened.
  - **He blamed the media for raising questions about the firm's financial disclosures, and government officials for allowing inflation to spike to the point where rapid interest rate increases were necessary** (sic).
- Hubris? Arrogance? Delusion? Incompetence?
  - "In a hierarchy every employee tends to rise to his level of incompetence." (Unknown attribution)

The culture inculcated by SVB's CEO

- *Fintech Nexus* (17/5/2023)
  - "Like any bank," he wrote, SVB invested the new rash of deposits in investment securities by making new loans. He said that SVB's Asset Liability Management Committee ("ALCO"), of which he was "not a member" but trusted implicitly, made a series of investments during this time in "low-risk, highly rated government-backed securities. He called these securities "safe" and available as collateral if the bank needed liquidity.
- Our take-away from this?
  - Incompetence? Misunderstanding? Complacency?
  - The CEO's view of ALCO was the traditional (pre-2008) view of the function and importance of the ALCO pre-2008
- PRA view on importance of ALCO and mandated requirement for C-suite to attend it

Credit Suisse

Slipping from one banana skin to another….and another….

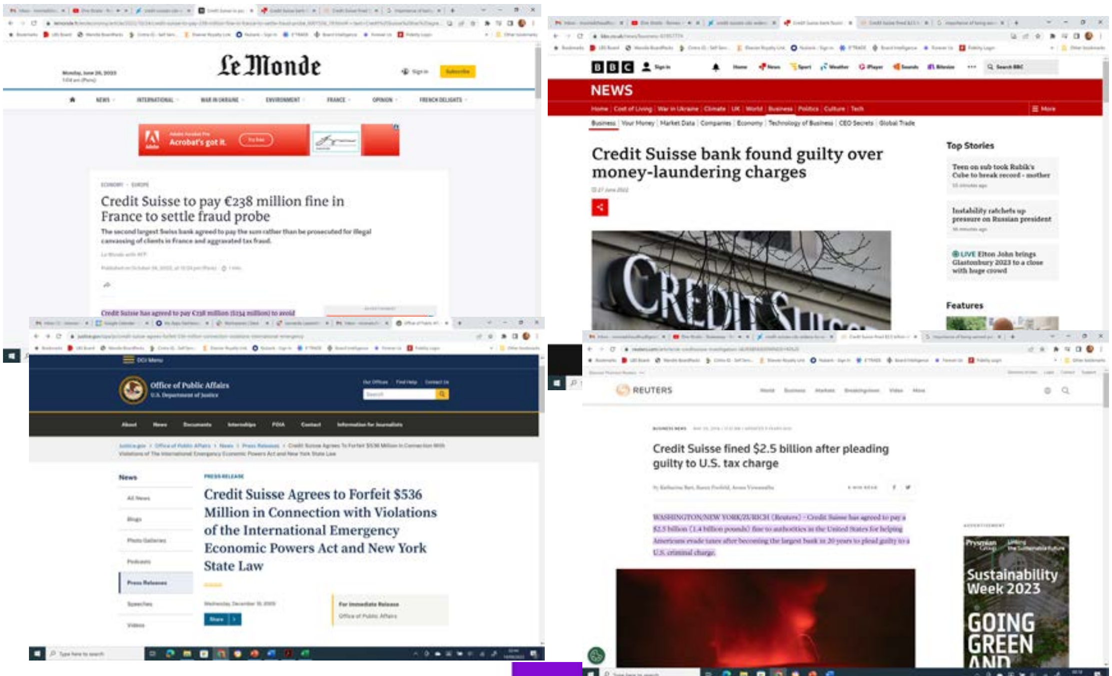
Credit Suisse risk culture

- The news stories around this particular “G-SIFI” bank had not been particularly positive for some years now
- It reminds me of this quote from *The Importance of Being Earnest*, a novella published in 1895…

“ To lose one parent, Mr. Worthing, may be regarded as a misfortune; to lose both looks like carelessness. ”

Oscar Wilde (The Importance of Being Earnest)

Sanctions violations, money laundering, tax evasion, fraud… …the list is optically endless!



CS: years of Mis-steps and Scandal

2019 – Corporate espionage: The bank hired private detectives to track two outgoing executives, including one who left to join rival bank UBS, triggering a regulatory investigation and the departure of then CEO Tidjane Thiam in 2020. Regulators also accused the bank of lying about the scale of the espionage.

2020 – Bulgarian money laundering: Swiss courts found Credit Suisse guilty of failing to run proper checks on clients and investigate the source of funds linked to a Bulgarian drug ring that laundered at least $146m between 2004 and 2008. The court found that the bank missed clear red flags such as the funds being stuffed in suitcases and two assassinations linked to a client.

2021 – Archegos Capital: The bank faced a $5.5bn loss due to its exposure to the US hedge fund Archegos Capital Management which collapsed in early 2021. A report published soon after blamed the losses on poor risk management practices and a “lack of accountability”.

2021 – Greensill Capital: Crédit Suisse was forced to suspend $10bn of investor funds after the collapse of supply-chain financing Greensill Capital whose loans were packaged and sold to Credit Suisse clients. Senior executives overruled risk managers to approve a $160m loan to Greensill which the finance company said there was “no conceivable way” to pay when it collapsed.

2021 – Tuna bonds scandal: The bank faced a $4750m fine for its role in the “tuna bonds” loan bribery scandal. In the scandal funds raised through debt issuance were spent on purchasing military equipment instead of being used to invest in a tuna-fishing fleet in Mozambique. The loans were not revealed to creditors and the IMF, triggering a crisis in Mozambique. Credit Suisse is set to face a 13-week trial in September 2023.

January 2022 – Chair resigns: António Horta-Osório resigned as Credit Suisse chair in January after breaking Covid quarantine rules in both Switzerland and the UK. Horta-Osório, who was brought in to reform the company’s culture, attended Wimbledon and the final of the men’s European championship on the same day. It was reported he also used the company’s private jet excessively.

Credit Suisse and risk culture

- Banking is, first and foremost, confidence
- A loss of confidence will lead, very quickly, in a loss of viability which leads inevitably to failure and resolution
- It is clear that the Board and senior executive at Credit Suisse were unable – or possibly unwilling – to address the kind of risk management environment that enabled the bank to lurch from one bad news story to another
- Yet I can attest personally (one or two of my friends work there!) to the fact that, optically, and on the surface, the ***bank’s “risk management framework” was as comprehensive and all-encompassing as any one would observe anywhere, at any bank***.
- All G-SIFI banks have very comprehensive RMF structures, policies and processes in place. All are under heavy regulator scrutiny. (Again I can attest personally from my four years at RBS Group Treasury…)
- In theory the RMF at CS was fit for purpose
  - But the bank was not doing what it said it would be doing.
- So in practice it wasn’t….

1_CREDIT SUISSE_Risk Net article April 2023.pdf - Adobe Acrobat Standard DC

26/04/2023, 10:36 Why tougher liquidity rules may not reduce the risk of ban...

Why tougher liquidity ru... may not reduce the risk of bank runs

EU regulator and industry experts say LCR reform is the wrong respons... to Credit Suisse and SVB

Costas Mourselas
@CostasMourselas
25 Apr 2023

I agree.
The "Lesson Learned" from 2023 bank failures answer is NOT further regulation….
…it is ***better risk culture***
That is something that, ultimately, only the bank itself can address

BTRM

1_CREDIT SUISSE_Risk Net article April 2023.pdf - Adobe Acrobat Standard DC

"The first place for regulators to look is with respect to capital and whether it adequately reflects the risks that the bank is taking," says Carolyn Wilkins, external member of the BoE's Financial Policy Committee and former senior deputy governor of the Bank of Canada.

"As the Bank of England has highlighted, there is also a question to be discussed on the international stage on the calibration of the liquidity coverage ratio."

However, a European national regulator argues the LCR is not designed to save a bank from idiosyncratic failure driven by generally poor risk management.

"Both Credit Suisse and SVB were not well run. The runs on these banks were very rational acts of market discipline," the European regulator tells *Risk.net*.

Many sources point out that, like all its standards, the Basel Committee describes the LCR as "a minimum supervisory requirement for banks", and that it is up to local regulators to tailor further liquidity stress tests for the unique features of their banks.

A veteran liquidity risk consultant and former bank treasurer says bank executives and depositors should not assume that meeting regulatory ratios is sufficient.

"Bank owners and managers have a different perspective from regulators," says the consultant. "The latter require sufficient liquidity to

Conclusion

- The components of an RMF in a bank are straightforward and generally not complex to implement
- What the events of 2023 have demonstrated is that simply having an RMF in place, while necessary, is not sufficient to prevent bank failure
- For an RMF to be effective, and to prevent failure for firm-specific reasons, its operation must be undertaken within an environment that promotes and fosters effective risk culture
- This is much harder to write about than the theory…

Recommendations for effective risk culture

- They were at the beginning! But here are some more:
- 1- only individuals who have demonstrated an ***observable, peer-confirmed*** track record of commitment to implementing a sound risk culture in banks should be elevated to positions of seniority in banks
- 2- Act on and make real the bank's formal risk management policies
  - Simplicity, succinctness and clear language at all times, in policy documents and process maps
  - Senior executives must lead from the front in building a team culture that emphasises a shared goal. Remuneration policy is part of this
  - Clear, accurate and succinct MI that is actually read by all senior execs
  - Genuine technical knowledge and expertise exhibited by the C-suite and the Board Directors
  - Governance framework (committee structure) that is effective and reviewed as such regularly
- 3- Embed risk management processes into the firm's daily practice through an effective risk culture
  - Policies only work if you follow them
  - 2LoD and 3LoD are only effective if their recommendations are acted on
- Embedding the role and influence of 2nd Line of Defence and 3rd Line of Defence within the business
  - Act on their recommendations!
  - 3LoD should be internal to the firm and not outsourced, so they are aware of the actual risk culture of the bank
  - Complete this picture: ________________ [firm-specific]

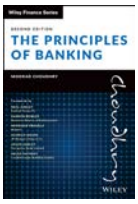
Assessing effective risk culture

- A positive risk culture includes the following attributes:
  - Employees at every level appropriately consider and manage risk as an intrinsic part of their day to day role, considering risk in any decision made, and taking responsibility for risks and controls.
  - Open communication is supported and encouraged ("Psychological Safety" – have we come across this?)
- In assessing culture we should consider the following aspects:
  - "Tone from the top";
  - Accountability
  - Effective communication and challenge.
- "Tone from the top": assess that
  - The leadership promotes, monitors, and assesses the risk culture of the bank; considers the impact of culture on safety and soundness; and makes changes where necessary.
- Accountability: assess that:
  - Relevant employees at all levels understand the bank's core values and its approach to risk, are capable of performing their prescribed roles, and are aware that they are held accountable for their actions in relation to the bank's risk-taking behaviour.
- Effective communication and challenge: assess that:
  - An environment of open communication and effective challenge is promoted in which decision-making processes encourage a range of views; and promote an environment of open and constructive engagement.

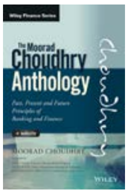
The Final Word

- How can we embed the right "risk culture" in banks?
- The answer is not "more regulation"….regulation is not culture, it is (and this is not to diminish it's vital role and importance in systemic safety) process and bureaucracy
- In the author's view, two things will help:
  - We adopt a view that "we are ALL risk managers." Managing risk is not the role of only the 2LoD or Compliance department
  - Only individuals who have demonstrated a track record of commitment to implementing a sound risk culture in banks should be elevated to positions of executive seniority in banks
- See the last slide in the Appendix which is from the "Afterword" to *The Principles of Banking, 2nd Edition….*
- …and speaks to "risk culture"
- "*The first principle of good banking…is to have principles.*"
  - The Author

Further reading



The Principles of Banking, 2nd Edition, Singapore: John Wiley & Sons Ltd 2022, chapters 11-15



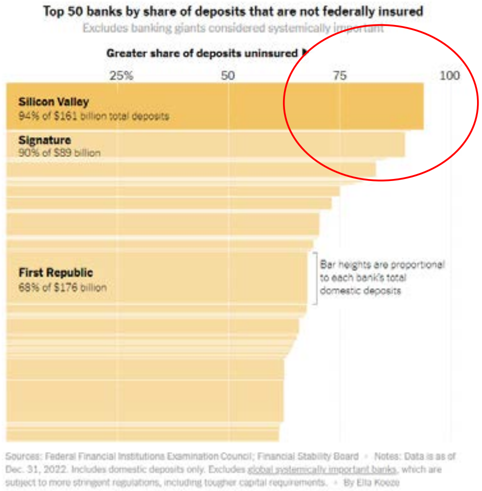
Moorad Choudhry Anthology: Past, Present and Future Principles of Banking and Finance, Singapore: John Wiley & Sons Ltd 2018, chapters 8, 10-14

Email: mooradchoudhry@gmail.com

Appendix

SVB: a concentrated funding structure

- SVB deposit customers were concentrated excessively in what the UK FSA used to call “Type A” deposits and depositors
  - Large corporates, often non-bank FI entities
  - High proportion of “uninsured” deposits
- These are not to be considered as “stable” funding
- But let’s take a step back…



Source: ICAEW 2023

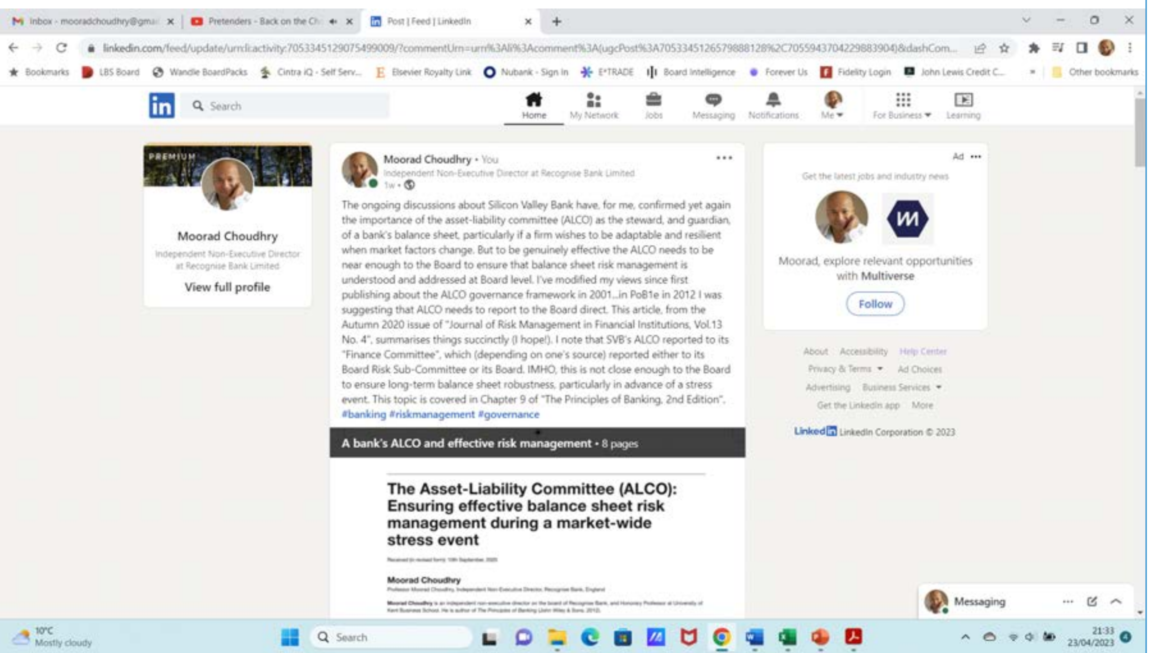
Liquidity risk management

- In the UK we have the concept of “Pillar 2 liquidity”, guidance from the PRA from 2016
- Amongst other things, it addresses:
  - Those risk types addressed by the FSA ILAA regime not covered by Liquidity Coverage Ratio (LCR)
  - Those risk types not covered by LCR and not previously covered by ILAA
- These include:
  - Funding maturity mismatch beyond a 30-day tenor (up to 90 days minimum)
  - Concentration of funding
- There is no “Pillar 2” or equivalence for non-systemic banks in the USA
- SVB had a high concentration of funding:
  - Concentration by depositor type (one commentator described them as “Crypto and VC @-----”)
  - Concentration by contractual maturity
  - Concentration by product type
- The bank was not obliged to report NSFR and LCR
- In any case, we note that SVB’s LCR at the time it attempted a Rights Issue was ~71%...below the 100% Basel III minimum
- Once the bank run started, the bank was doomed
- ***But the funding structure itself was always more vulnerable to a bank run following loss of confidence than a bank that followed “Pillar 2” discipline***
- ***This caused failure…the loss of confidence that leads to a bank run was not mitigated in any way***

SVB Governance structure

- SVB's asset-liability committee (ALCO) reported into the "Finance Committee"
- The Finance Committee reported into the Board, or, depending on media source, the Board Risk Sub-Committee
- As we have observed with bank failures in 2007-09, and again in 2023, this (orthodox and very common) operating model places genuine understanding of the balance sheet – and its risk sensitivity to changes in market factors – too far away from the Board

ALCO and distance from the Board



Article (2017) from European Financial Review: http://www.europeanfinancialreview.com/?p=17469

These words remain relevant in 2022, and I daresay will be in 2032 or 2122. But what I have learned since the first edition was published is this: it is easy, very easy, to *write* these things in a Word or PowerPoint file. It is even easier to *say* them, and easier still to stand up and present them to an audience, because no-one will disagree with you. The challenge lies in *actually doing them*. Making them happen. Making them *reality*. That is the problem that bank managers face – how to make real, in practice and in their day-to-day business, what is written down in policy statements and governance frameworks.

We should remember that in the years leading up to 2008 it was not exactly as if banks operated in some kind of lawless "Wild West" environment, without governance frameworks, regulatory rules, Board Audit and Risk Committees, ALCO committees, risk appetite statements, chief risk officers, risk exposure limits, 3rd line of defence and the like. They had all of these things. That didn't stop one or two of them from going bust. And yet still, years after the bank crash, in 2021 one or two banks found that their approach to managing risk exposure to counterparties such as Greensill Capital and Archego was still inadequate. This after more than ten years of onerous, prescriptive, and all-encompassing regulatory supervision, more than ten years after the introduction of "Basel III" guidelines, over ten years of ICAAPs and ILAAPs, ten years of SREP visits, countless periodic summary supervision meetings, Internal Audit reviews and recommendations, "Big 4" consultant reviews and recommendations, conference seminars, and so on and on and on.

The challenge isn't in formulating a fit-for-purpose governance structure and risk management framework – that's the easy bit. The challenge lies in actually doing it, making it happen, making it *real*. That isn't necessarily something that one can learn from a book. And I'm not entirely convinced it is something that can be taught anyway, no matter how many "continuing professional development" (CPD) hours one puts in every year, or how many consultants one pays to come in and provide not inexpensive advice. It comes from individual character and ethics. Character and ethics would appear, to me, to come from somewhere else. The vast majority of those employed in banking demonstrate sound ethical principles and technical understanding. But, as in any profession, there are always some exceptions.

DISCLAIMER