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The Certificate
of Bank Treasury
Risk Management

Risk Governance in Banking

BIBM, Dhaka

Thought Leadership Series #10

Professor Moorad Choudhry
Faculty BTRM

31st March 2024

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Bangladesh Institute of Bank Management
বাংলাদেশ ইনস্টিটিউট অব ব্যাংক ম্যানেজমেন্ট

Your speaker

- **Professor Moorad Choudhry** is an independent non-executive director at Recognise Bank Limited in London, a non-executive director at the Loughborough Building Society and a non-executive director at Wandle Housing Association. He is Honorary Professor at University of Kent Business School.
- Previously he was CEO at Habib Bank Zurich (London), Treasurer, Corporate Banking Division at The Royal Bank of Scotland, Head of Treasury at Europe Arab Bank, Global Head of Treasury at KBC Financial Products and a vice-president in structured finance at JPMorgan Chase Bank. He began his career at the London Stock Exchange in 1989.
- Moorad is a Fellow of the Chartered Institute for Securities & Investment, a Fellow of the London Institute of Banking and Finance, a Fellow of the Global Association of Risk Professionals, a Fellow of the Institute of Directors and a Freeman of The Worshipful Company of International Bankers. He is author of *The Principles of Banking* (John Wiley & Sons 2012, 2022).
- Moorad was born in Bangladesh and lives in Surrey, England. He was educated at Claremont Fan Court school, the University of Westminster and the University of Reading. He obtained his MBA from Henley Business School and his PhD from Birkbeck, University of London.

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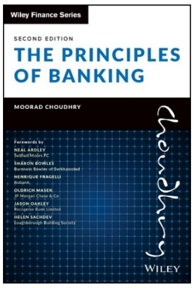
Agenda

- Governance structures and "enterprise risk management"
- Embedding risk management processes into the firm's daily practice through an effective risk culture
- Credit Suisse: a case study in the wrong culture
  - How to 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."*

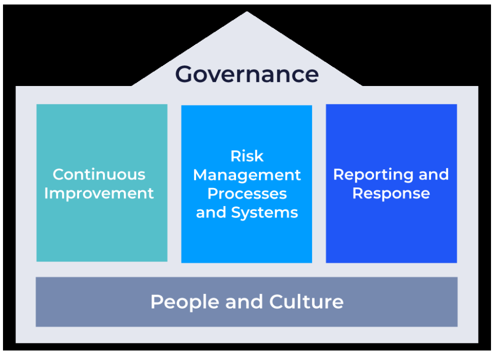
This is "Risk Culture": actually doing what you say to your stakeholders you will be doing…

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***
  - ***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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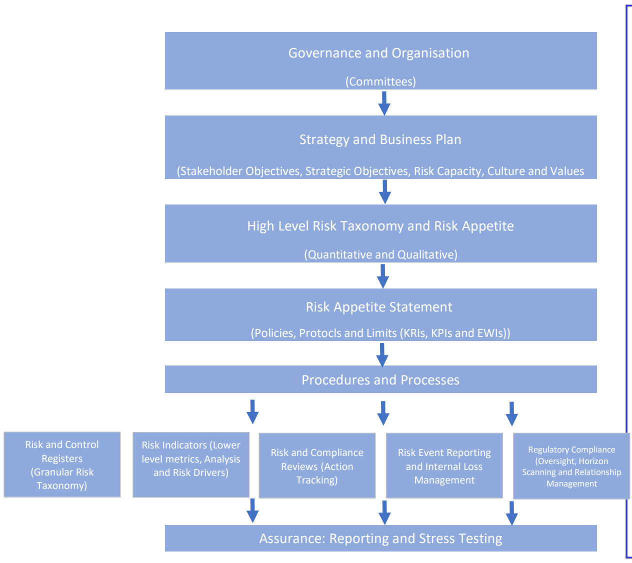
ERM in banks

- 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?

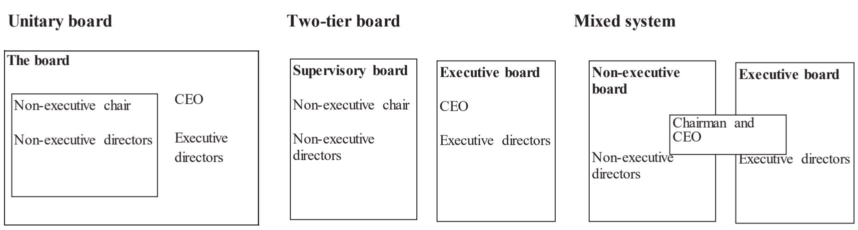


- **This incorporates:**
  - Committee structure and authority
    - Board and Board Risk + ALCO Committees
    - Mandate + delegated authorities
  - Holistic approach
    - Risk Management philosophy and
    - key principles
    - Link to strategic planning capital + funding frameworks
  - Risk Culture, 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

Board structure

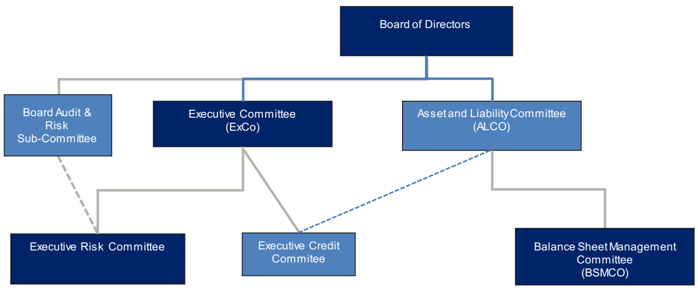
***The Principles of Banking*, 1st edition, Figure 18.1**

- Board structure is not universal, there is more than one model



The 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;
  - 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 the 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.
- The bank's strategy is to concentrate on customer lending and deposit-taking activities 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

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Risk strategy…*an ongoing process*

- Risk strategy setting and finalisation should be undertaken principally by 1st LoD risk owners, with input and oversight provided by the 2nd LoD function, to provide:
  - a bank-wide view of the current risk landscape;
  - where the bank thinks it needs to be in 12-18-24 months;
  - and the actions that it perceives will need to be taken in 12-18 months.
- ***The key outcome of the risk management strategy process is a series of actions which the businesses have agreed will be required to ensure that the management of risk remains fit for purpose***.
- An example to illustrate what this output might look like is shown in the table overleaf…..
- …these actions would be reported through Exec RiskCo to Board RiskCo on a quarterly basis to maintain full visibility of progress

Risk strategy…Example of output of risk strategy process

Risk Area	Action Proposed	Responsible	By	Committee
Operational	Develop corrective and detective controls	C&PD	Sep 22	ERC
Third Party	Train new technology analyst resources in 3rd party management	CTO	Sep-22	Exec
Op Res	Ensure BCP training also includes operational resilience training	CTO	Sep-22	ERC
Cyber	Assess the bank against Cyber Risk baseline	CTO	Sep 22	Board
Credit	Implement 2LoD quarterly reporting of Sectors, concentration, and sampling reporting to ERC	CRO	Sep-22	BRC
Third Party	Implement 3rd Party training – company wide	CTO	Oct-22	Exec
Op Res	Undertake operational resilience exercise	CTO	Oct-22	BRC
Op Res	Develop the operational resilience database and dashboard	CTO	Oct-22	Exec
Strategic	Implement appropriate stress testing of the business plan to inform planning and management actions	CFO	Dec-22	BRC
Liquidity	Develop limits for maturing deposits	CFO	Dec-22	ALCO
Credit	Undertake annual gap analysis of IRB data requirements to support any future consideration of IRB implementation	CCO	Annually	ERC
IRRBB	Implement a net interest income risk KRI as articulated in the ICAAP development section	Treasurer	Dec-22	ALCO
Climate	Finalise Climate Change Risk Appetite wording and Phase 1 Loan Classification	CCO	Dec-22	Board
Climate	Clear plan for 'green' product development	CCO	Dec-22	ExCo
Climate	Develop the capability for financial risk assessment and scenario testing which will include consideration buying in of benchmarking data	CFO	Dec-22	BRC
Cyber	Commission a 2LoD review of the cyber risk and control framework	CRO	Sep-22	ERC
Op Res	Review assessment of resource to support operational resilience	CTO	Sep-22	ERC
Liquidity	Back test deposit maturity retention assumptions	CFO	Dec-22	ALCO
IRRBB	Back-testing IRRBB forecasts against actuals	CFO	Dec-22	ALCO

Risk strategy…Example of output of risk strategy process: 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

- The most 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.
  - **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 and are 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 >>>
  - "The balance sheet is everything!" (RBS Group Treasurer to the author, 2010)

Risk Culture

Risk culture

- "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 (very 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**

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)

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)…

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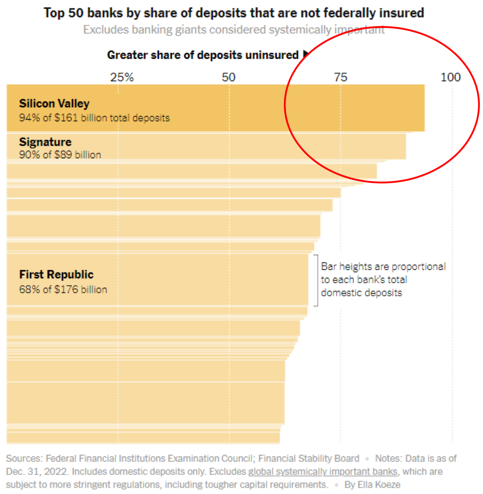
Concentrated funding structure

- 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

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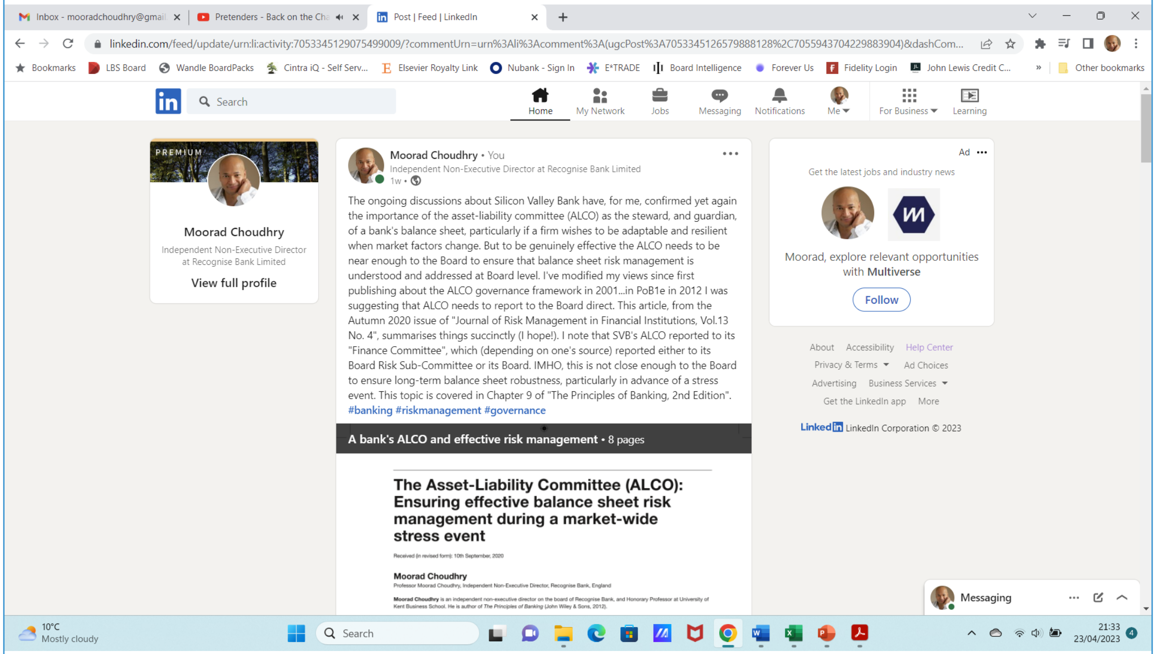
Liquidity risk management

- 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

Credit Suisse

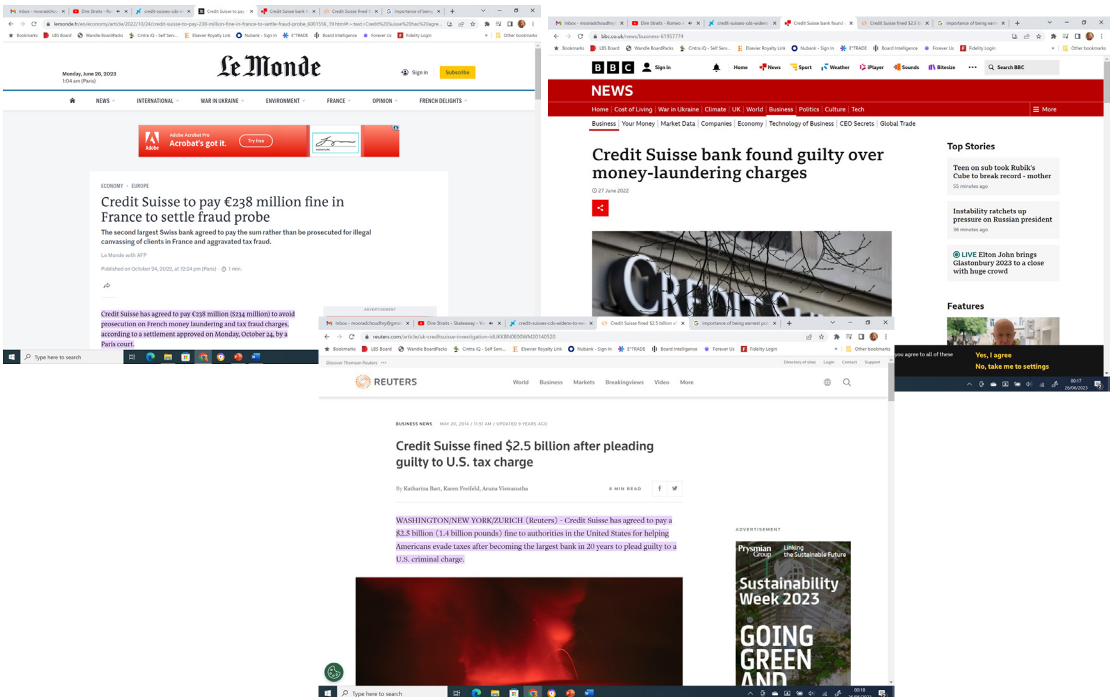
Slipping from one banana skin to another….and another….

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)



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:Credit 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.

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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
- In practice it wasn’t….

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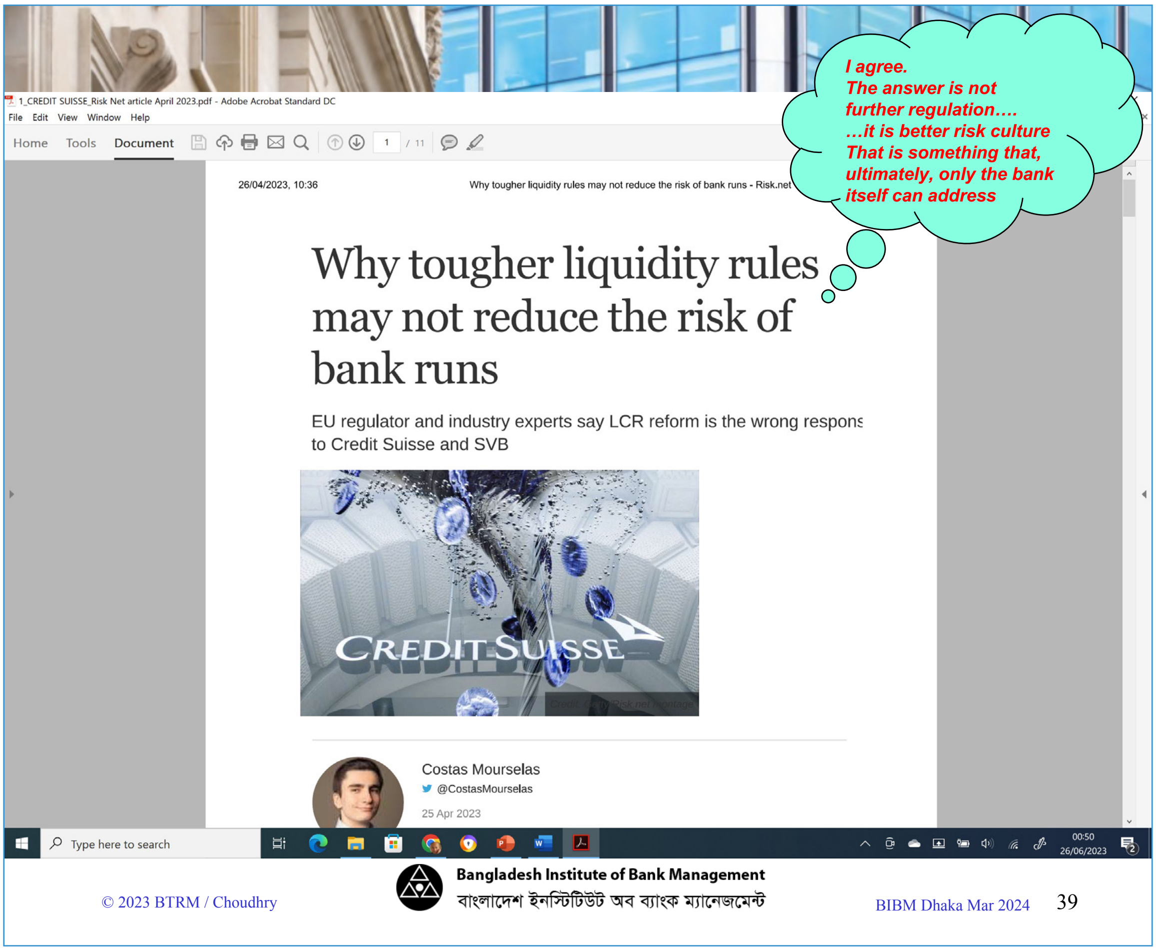
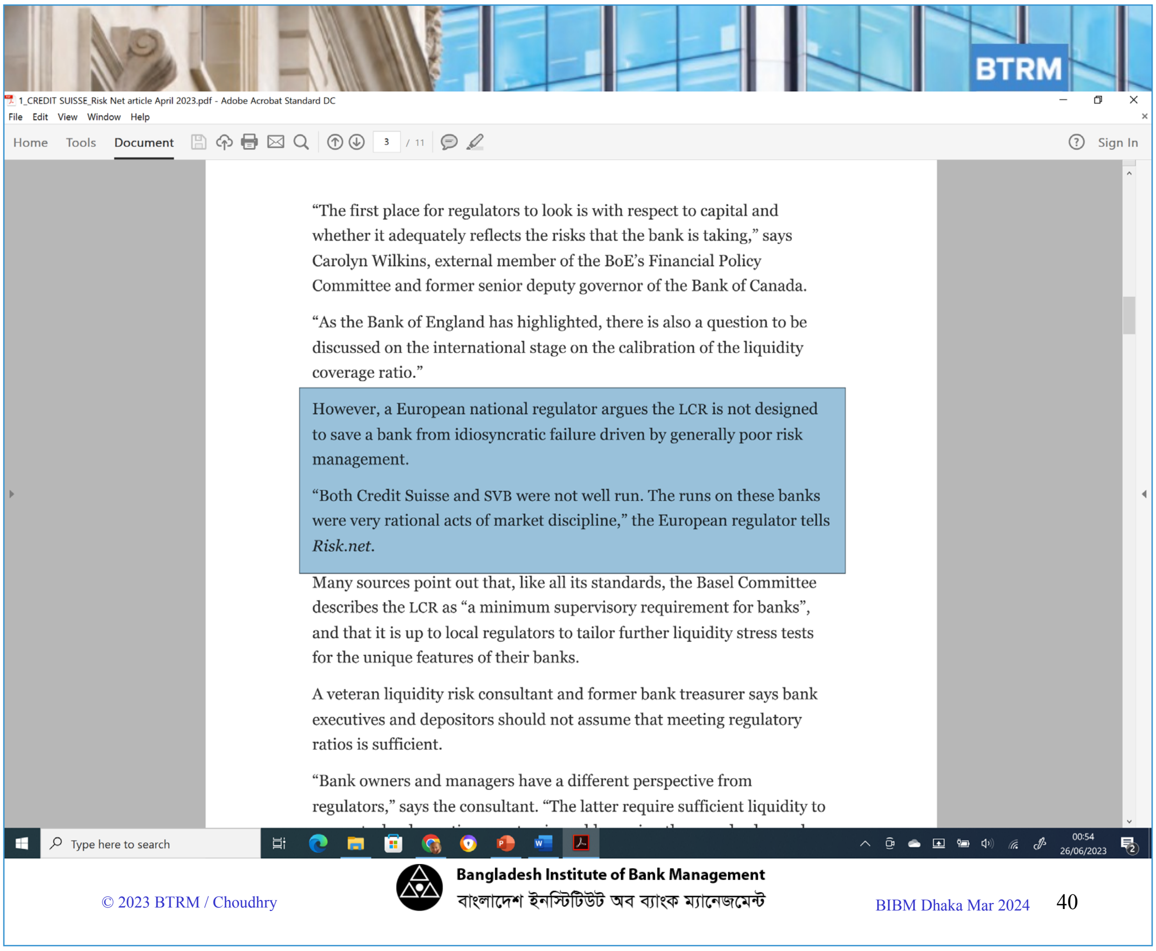


26/04/2023, 10:36 Why tougher liquidity rules may not reduce the risk of bank runs - Risk.net

Why tougher liquidity rules 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



"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 youi 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]

Who should undertake and report on this assessment?

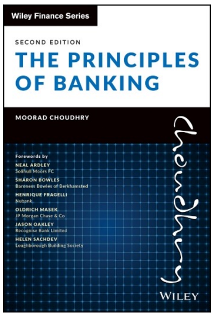
Assessing effective risk culture

- 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 soley the role of the 2LoD and 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
- I recommend reading the "Afterword" to *The Principles of Banking, 2nd Edition….*
- …summarised as:
- "*The first principle of good banking…is to have principles.*"

READING



- ***The Principles of Banking, 2nd Edition***, John Wiley & Sons 2022, Chapters 18-21
- https://www.amazon.com/Principles-Banking-Wiley-Finance/dp/1119755646/

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