

COMMENTS ON FSB's DRAFT GUIDANCE ON SUPERVISORY INTERACTION WITH FINANCIAL INSTITUTIONS ON RISK CULTURE

- i. Following the adoption of risk-based supervision, which emphasizes on better regulation as opposed to more regulation and which is cost effective, increasing the intensity of supervision as proposed in the Consultative Document, may conflict with risk-based supervision approach. This is because the depth of supervision will be higher than that required under risk based supervision. Therefore, there may be need for a clear definition of what **intense supervision** means in practice and to what extent supervisors will intervene in strategic decisions in their role.
- ii. Optimal Resource Utilisation – We appreciate that the adverse consequences of the 2007/2009 Global Financial Crisis necessitated a relook at the supervisory approaches. However, in our opinion, the focus should mainly be on Systemically Important Institutions whose failure are bound to cause widespread financial shocks in the financial system. Though it is indicated that the FSB's efforts are to reduce risks posed by SIFI's, we are of the opinion that the Guidance should explicitly provide that the focus is on SIFIs from perspective of every jurisdiction. This is because intensifying supervision on all institutions may not result in optimal resource utilization by the supervisors. Risk Based Supervision is still relevant despite the global financial crisis and what are required are additional supervisory measures for Domestic Systemically Important Institutions.
- iii. Balance between effective supervision and micro-managing – The assertions on page 3 that “Supervisors should not view an assessment of risk culture as a point in time review, but as part of the ongoing assessment of the firm” and on page 4 that “Since the global financial crisis, supervisory approaches are increasingly becoming more direct and more intense to promote the resilience of the financial system” may seem to imply the need for more regulation/supervision instead of effective/better regulation/supervision. This may be misinterpreted to mean supervisors will start micro-managing institutions, whose consequences are contrary to the objectives of regulation.
- iv. **Tone from the top** has been adequately elaborated and bank supervisors would be able to assess if such tone exists. However, the draft also observes that the appropriate tone and standard behaviour “at the top” is a necessary condition for promoting sound risk management but also observes that for lasting change, the tone and behaviour “**in the middle**”, and indeed **throughout the institution**, is also important. For ease of reference by supervisors, it would be important to clearly state the indicators/variables associated with the “**tone and behaviour in the middle and throughout the institution**” in evaluating the extent to which a bank subscribes to a sound risk culture.
- v. With the proposed increase in supervisory involvement in governance (Tone from the top) and strategic decisions, this may likely lead to adoption of similar business models since only strategies perceived to be relatively low risk will be acceptable to regulators. This may be misinterpreted to mean that supervisors are risk-averse and not supporting new innovations, which carry higher risks than the norm.
- vi. Accountability at the top – On pages 6 and 7, the board and senior management are expected to establish a policy of ownership of risk where employees are held accountable

for their actions. These assertions seem to imply that only employees (middle and lower levels) are to be held accountable and the board and senior management left out. Concerns have increasingly been raised where board members and senior management of institutions earn huge packages despite dismal performances of the institutions. In this regard, the guidance may need to reflect the need for accountability for risk management outcomes at all levels of the institution.