To: Financial Stability Board, Basel (fsb@bis.org)

Date: 31 January 2014

Re: CRO Forum response to Consultative Document on Increasing the Intensity and Effectiveness of Supervision from 18 November 2013

The CRO Forum welcomes this opportunity to respond to the Consultative Document on "Increasing the Intensity and Effectiveness of Supervision" published on November 18th 2013. The CRO Forum is an association that was formed in 2004 to advance risk management practice in the insurance industry. The CRO Forum member companies are large multi-national insurance companies. Our members are headquartered across the world with a concentration in Europe (for further details see: http://www.thecroforum.org/).

The CRO Forum **agrees with the underlying principle set out in the paper**, that the time and effort a financial institution puts in building its risk culture is indicative of the importance it places in adopting an approach to its business that adequately balances risk with return. Among other things, a strong risk culture forms part of the criteria used by the insurance industry when assessing the granting of risk coverage for their clients.

We feel, however, that **the Risk Appetite Framework (RAF) is the embodiment of an institution's risk culture**, and that it is unnecessary to go beyond assessing the robustness of the RAF to assess the importance an institution places on risk culture. Therefore, the **guidelines for assessing risk culture should avoid adding new layers** or expectations of new processes being created and leverage existing tools and requirements to assess risk culture. This is especially true where the paper states that "supervisors should assess how the board and senior management systematically assess the risk culture of the institution". We firmly believe that the tools in place to assess the effective implementations of the RAF are the same tools that allow to assess whether the risk culture has been properly diffused.

With reference to the point in the introduction on the "ability [of supervisors] to engage in high-level sceptical conversations with the board and senior management", we would interpret this as a way for supervisory authorities to challenge the assumptions underlying the risk appetite statement by having an insightful and forward looking conversation on the RAF with the board. We would not interpret this as regulators expecting the institution to be auto-critical about its own setup, when discussing with supervisory authorities.

Also in the introduction, the paper states that "A risk culture that promotes prudent risk taking (…) supports an environment that is conducive to ensuring the emerging risks (…) are [managed] in a timely manner". As stated in our previous response to the consultative paper on "Effective Risk Appetite Frameworks" **CRO Forum members strongly believe that risk culture, together with risk appetite, should not necessarily reflect a prudent approach, but fit the business purpose of the firm**, within the boundaries of its capacity, and in line with its desire for growth.

In the introduction to section 3 on General supervisory guidance, the paper states that "Assessing risk culture entails identifying the root cause of why there are supervisory findings – not just what the findings are." **CRO Forum members agree that risk culture should be considered as a potential cause for supervisory findings**, however, we challenge the practical implications of the statement. There is a potential that this guideline may lead to lengthy reviews of the "intent" of the actions which

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led to the risk failing as opposed to focusing on the actions and circumstances which caused the risk failings. We would encourage further clarity on this statement.

In the section that deals with the Tone from the Top indicators, there are certain statements made that we believe could be improved by rephrasing or rewriting:

- Point 3.1.9 states “The board and senior management demonstrate a clear understanding of the quality and consistency of decision-making throughout the business …”. Our concern is that the term “quality”, in the absence of a clear definition, could lead to being measured according to the consequences of decision making. We would suggest removing the term “quality”.
- Point 3.1.10 states “The board and senior management have clear views on the business lines considered to pose the greatest challenges to risk management, such as unusually profitable parts of the business, and these are subject to constructive and credible challenge about the risk-return balance.” Since unusually profitable parts of the business do not necessarily misalign with or pose challenges to an organizational approach of risk management. The CRO Forum believes removing the words “unusually profitable parts of the business” would clarify the statement.
- Finally, we would suggest to rephrase point 3.1.13 to avoid potential misinterpretation that every time a failure occurs this would lead a an institution to necessarily implement change.

In the section that deals with the Accountability indicators, we would challenge the points that make reference to clearly stating the consequences of being non-compliant with desired risk management behavior. While **we recognize that it is important that people are aware of the consequences**, for certain types of behavior, being too specific about applicable actions and/or sanctions can create unintended outcomes by empowering individuals to make the wrong decisions, based on their interpretation of the consequences. **Far more important is that an organization promotes the existence of 'institutional justice'** to address actions and judge the appropriate response in the circumstances. The existence and application of institutional justice is a better indicator that corporate values in general will be adhered to and risk culture in particular.

Another point that the CRO Forum members would like to bring to the attention of the FSB is the assumption, stated in the definition of the indicator on Accountability, that “all employees at all levels must understand the core values of the institution’s risk culture”. Although **we believe that all employees at all levels must understand the core values of an institution**, we do not believe that the institution’s approach towards risk needs to be communicated in the same way to all employees. We believe risk culture should be fully embedded at the level at which decisions are being made. Management should receive reporting about, and should be required to fully understand the part of risk appetite and risk profile of the institution that concerns his/her area of responsibility, and thus the risk culture applicable to his/her area of responsibility. Likewise, where risks are applicable to all tasks performed (e.g. operational and compliance risks), every employee should receive training and information on the core values of the institution and how this should affect their behavior in fulfilling everyday tasks. For instance, it should logically flow from an institution that values integrity, that it would build appropriate whistle blowing procedures and expect every employee to alert it in case of internal fraud. The institution does not necessarily need to communicate further about its “risk culture” towards operational risk other than the core values that underlie the behaviors that are expected from its employees.

Finally, CRO Forum members would like to highlight some practical difficulties in implementing the requirements put forward by the paper, mainly due to contrasting principles:

- The first concerns the requirement to lessen the influence of dominant personalities in the organization so as to avoid that risk culture be built around their individual behaviors rather than around the values of the institution itself. At the same time, the paper requires strong leadership and that corporate bodies lead by example. **We find that it is in practice difficult to define a clear line beyond which a strong leader becomes too dominant a personality**, specifically when corporate values continue to be adhered to. What needs to be ensured is that the system of checks and balances set up in the framework of corporate governance is applicable to all employees, no matter his/her rank.
- The second concerns the difficult concept of accountability. As the corporate governance framework and oversight structures continue to increase in complexity and size, they also contribute to diluting responsibilities making it increasingly difficult for institutions to define what an individual employee is accountable for.
- The last concerns the requirement to learn from failures. While this is an interesting concept in theory, in practice, experience shows that it often requires strong leadership and a dominant personality to implement effective behavioral change in the institution.

As concerns the specific questions posed by the FSB in their follow up questionnaire, please find hereafter our specific answers:

General questions

1. Are there areas not addressed in the Guidance that should be considered in assessing risk culture?

   No, we feel the main areas have been covered

2. Are there areas of the Guidance where further elaboration or clarity would be useful, without becoming too granular?

   No, we feel the paper reflects an appropriate level of granularity and remains principles based.

3. Would the Guidance benefit from further elaboration on the definitions of corporate culture, risk culture and sub-cultures within business lines, and on the relationship between them?

   No, we feel that risk culture is a concept that is so specific to a company that it should not be standardized in any way without the risk of creating administrative and window dressing exercises that add no value to the institution

4. What tools would assist, in particular supervisors, to effectively assess the risk culture of financial institutions (e.g. interviews, questionnaires, analyses of internal documents such as board self-assessments, code of ethics for employees, risk appetite statements)?

   As stated in our general comments, we feel that the tools in place to assess the effective implementation of the RAF should be the same tools that serve to assess whether risk culture is properly diffused in the corporation. Where supervisors desire to give a wider definition to risk culture that stretches to also cover more generally corporate values, tools and frameworks in place used by the human resource function are to be considered.

5. What is the expected supervisory response if, for example, the board of directors failed in its responsibility of setting the adequate tone from the top and consequently in promoting a sound risk culture?

   We feel that the statement "assessing risk culture entails identifying the root cause of why there are supervisory findings not just what the findings are" is an important point that is quite logically *followed up by a requirement for supervisors to "highlight to the board the behaviors that underpin supervisory findings". We feel that this requirement, will be difficult to implement in practice because subject to interpretation. In these initial stages of implementation and experience in discussing root causes to supervisory findings, we would caution in setting any form of coded sanctions until there is a far clearer idea of what are the key recurring causes to breaches in risk culture.*

6. What suggestions do you have to improve the engagement of supervisors with financial institutions on risk culture, in particular when discussing the underlying causes of behavioral weaknesses?

   See above response.

Indicators of a sound risk culture

7. Are the indicators identified in the Guidance sufficient for assessing risk culture and adequately capturing the multifaceted nature of risk culture?

   We would add another indicator that concerns job rotation between control functions and business lines. We find that where control functions can offer competitive remuneration, attracting and retaining talent, this creates a healthy and virtuous circle where business knowledge is brought to the control functions helping them to become more efficient and concrete, and risk awareness is introduced in the decision making processes of the business.

8. Are there specific examples of good practices that can be used to support the indicators?

   While there are good examples, supporting indicators with examples could become benchmarks and may not keep pace with evolving risk management

9. Are the indicators identified in the Guidance commonly considered by the board and senior management when internally discussing risk culture? Are there other indicators that should be included?

   Indicators commonly discussed when assessing risk culture are the same that are discussed to assess how well the Risk Appetite Framework is embedded. We do not feel other indicators should be included.

10. Does the paper appropriately describe the different roles of the board, senior management and other control functions in relation to defining, implementing and monitoring risk culture?

    Yes

11. What tools or processes are used to make risk culture tangible within the organisation?

12. Are there useful descriptors of an institution's risk culture, both good and bad, that would be helpful to include in an attachment to the paper? For example "growth for growth's sake" or "it's someone else's problem".

Once again, we thank the FSB for the attention brought to these comments and look forward to a constructive dialogue with our supervisors on risk appetite frameworks.

Yours Sincerely,

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CRO Forum Chair

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