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Starling Trust Sciences, LLC
Washington, DC

Ladies and Gentlemen:

The American Bankers Association (ABA)¹ is pleased to respond to the public exposure draft of Starling Insights' *Deeper Dive Report* dated November 17, 2025, on "Supervisors on Supervision" (Draft Report).² ABA notes the extensive public debate since the financial crisis of 2007-2008 about institutional "culture" and the role it may have played in the build-up to the crisis. Prominent in those debates has been the difficulty in even defining "culture" in the context of financial institution management and performance, effective institution supervision, and financial system stability. Such discussions have contributed to a useful thought process, including (and perhaps primarily) within institutions themselves, but much work remains if cultural considerations are to become a useful part of financial supervision without compromising the analytical rigor and transparency of supervisory processes.

In summary, ABA believes that institutional culture is an important component of risk governance. Supervisory approaches to culture, however, must remain grounded in transparent, principles-based frameworks focused on material financial risk. Developing an appropriate supervisory approach raises many complex issues. A governance framework establishes the parameters within which the institution takes on, mitigates, and avoids risk, together with related explicit processes and procedures – all part of the "what" of risk management. We believe "culture" in this context is part of the "how" – the actual behaviors that put risk governance into practice and make it effective. If practices are inconsistent with the institution's express risk appetite and policies, risk management will be ineffective, and material financial losses are likely.

A second but also important aspect of institutional culture goes beyond risk management, however: an institution's culture, again as expressed in management and employee behavior, is essential to establishing and maintaining the institution's brand, common values, and business priorities. This aspect of culture will be reflected in the institution's treatment of customers and counterparties, its reputation, and its general business results, financial and otherwise.

ABA also emphasizes thoughtful consideration of the proper role of supervisors in the context of culture. Stating the obvious, risk management governance is directly related to a firm's exposure

¹ The American Bankers Association is the voice of the nation's \$25.3 trillion banking industry, which is composed of small, regional, and large banks that together employ approximately 2 million people, safeguard \$20.1 trillion in deposits and extend \$13.5 trillion in loans.

² Available at <https://insights.starlingtrust.com/supervisors-on-supervision>.

to material financial risk. Thus, a firm’s culture as an aspect of risk management, *i.e.*, the degree of consistency with which leadership, lower levels of management, and employees perform day-to-day in line with the firm’s risk appetite and risk governance policies and procedures, is appropriately within the scope of supervisory review. This review should, however, be grounded in transparent, principles-based supervisory guidance, allowing supervision to be tailored appropriately to an institution’s risk profile. Moreover, consistent with recent clarifications from U.S. supervisory agencies, supervision should focus on consistent application of an institution’s risk governance framework and consequences directly related to material financial risk³; the second aspect of culture, concerned with the institution’s brand, common values, reputation, and business priorities, is properly the responsibility of the firm’s management.

The remainder of this letter expands on these considerations by addressing selected questions posed for comment with the release of the Draft Report.

Responses to Culture Risk Questions

1.1 Definitional Ambiguity and Supervisory Hesitancy

1.1 (a) How should we define culture in a manner that demonstrates the importance of culture to the task of supervision? Does culture only matter in so much as it directly affects risk and compliance functions (commonly discussed in terms of “Risk Culture”); or is prudential relevance of culture broader than this (often discussed in terms of “Culture Risk”)?

First and foremost, culture is a matter not just for supervisors, but for institutions’ leadership and management. An institution is responsible for establishing, maintaining, and transmitting an organizational culture to guide its team members’ behavior through effective implementation of not only its policies and procedures, but also its day-to-day business routines and expectations for its executives and employees, and ultimately for its values and key strategic, operating, and business objectives.

Therefore, ABA believes that, once a firm has established its risk appetite, specific risk policies, business routines and objectives, and fundamental values, “culture” is an expression of the degree of consistency and effectiveness with which the firm’s board, executives, and staff actually implement those stated principles, objectives, and requirements. As with any human organization, a degree of monitoring and oversight is an integral part of a successful business, but a key manifestation of an effective culture is a high degree of compliant personal behavior,

³ See the OCC’s and FDIC’s proposal regarding Unsafe or Unsound Practices / Matters Requiring Attention (Unsafe or Unsound Practices/MRA Proposal) published at *Federal Register*, Vol. 90 No. 208, 48835 (October 30, 2025). See also the Board of Governors of the Federal Reserve System Division of Supervision and Regulation [Statement of Supervisory Operating Procedures](#) dated October 29, 2025.

independent at least to some extent of the threat of adverse consequences, but strongly supported by compensation frameworks and other policies (discussed in more detail below).

Under this formulation, therefore, risk management and legal and regulatory compliance imperatives are major elements of a healthy organizational culture. As noted, risk culture is an important component of risk management programs, systems, and processes (collectively, “Risk Management Practices”), along with other components like risk identification and control assessment, monitoring, testing, and reporting. As discussed in more detail below, Risk Management Practices are the most appropriate subjects for supervisory scrutiny. Beyond those, however, organizational culture is a means to promote efficient and coordinated operations, in which team members across the organization conduct their activities in a manner that minimizes conflicts between objectives. When objectives present some inherent potential for conflict, *e.g.*, increasing quarterly profit and managing to the desired risk appetite, cultural influences lead promptly to an appropriate and robust, balanced solution, *e.g.*, an appropriately calibrated risk-adjusted return, aligned with the broader risk management framework.

Note that this “culture” definition encompasses the often-underscored “tone at the top,” an indispensable element of an effective culture. The right tone at the top is insufficient by itself, however – implementation of an effective culture also requires consistent implementation below the “top,” throughout whatever lower management layers exist, with particular importance for roles having some extra element of leadership (prominent roles highly visible to other employees and to firm counterparties, customers, and, perhaps especially, for banks, the general public).

Thus conceived, “culture” is the connection between risk appetite, detailed policies and procedures, business objectives and routines, and organizational values, on the one hand, and actual implementing behavior, not only at the top but down through the ranks. “Culture” is what actually happens at the firm on an ongoing basis, the actions that speak louder than words. As a key aspect of risk management and compliance, it is undeniably an appropriate subject of supervisory concern. Responsibility for culture begins with firm management, however, and with the recent clarification of U.S. supervisory standards to deemphasize supervision of reputation risk, the role of culture in establishing the firm’s brand and reputation with customers, business counterparties, and the public remains the province of management.

1.1 (b) Some discuss culture in terms of “non-financial risk” or “material operational risk.” Does either formulation offer an effective framework within which to contemplate matters of culture within commonly used frameworks of supervision?

Consistent with the discussion under 1.1(a) above, a firm’s culture is relevant to management of non-financial and operational risk, among all other types of risk. From the perspective of firm management, it is axiomatic that most commonly imagined types of risk can eventually be the

source of adverse financial outcomes if poorly managed, certainly if ignored.⁴ Recent increases in cyber threats and fraud represent operational risks that present great potential harms to firms if inadequately addressed; a firm culture that includes robust monitoring and testing, among other things, makes detailed risk management policies effective.

After the firm adopts appropriate protective policies and procedures, it must budget for adequate investment in personnel, vendor services, and software and other tools to make them effective. In many cases, the team will raise competing budget priorities, and if resources are scarce, management may face hard choices. An organizational culture that effectively manages such risks will acknowledge and take into account, for example, that the firm must balance investing in new revenue opportunities with defenses against potential losses. As discussed in more detail below, it must also align its compensation practices to hire and retain appropriately qualified and experienced risk managers, as well as qualified and experienced business generators.

1.1 (c) What is the relationship between governance, risk management, and culture? Which is of paramount in terms of supervisory significance? Is culture to be viewed as a byproduct of formal risk and governance infrastructure, or is it better viewed as a driver of performance outcomes? Can these matters be assessed independently? If so, should culture be assessed independently of governance and risk management? Why/not?

Basic financial institution examination focuses on how well financial institutions identify, measure, monitor, and control the risks associated with their products and services, including the channels used to offer their products. Risk culture sets the overall tone of a financial institution's Risk Management Practices, which examiners can sense during pre-examination meetings and throughout the examination, as well as guiding the institution's implementation of its practices. With regulatory agencies focusing on material financial risks, a firm's risk culture can influence examination outcomes – positively or negatively. Strong or weak Risk Management Practices will quickly inform examiners' perceptions of how well an institution is identifying, measuring, monitoring, and controlling risks.

1.1 (d) With culture defined as a matter of supervisory significance, what is the relationship (if any) between culture and a firm's stated purpose? Its espoused values? Its ethical stance and practice? The 'fitness & probity' of its board and executive management? (Etc.) Are such matters also rightly viewed as being of supervisory significance? Why/why not?

⁴ This statement, from the perspective of the firm's management, is distinct from the subset of risks that are the proper province of supervisors. The recent shift among U.S. financial supervisors to focus on "material financial risks" [citation] represents a rebalancing of supervisory agency priorities; firm managements' focus is a distinct discipline.

See response to 1.1(a) above. ABA believes there is an important distinction in the scope of culture that is appropriate for supervisory review and the wider scope that is management's responsibility.

1.2 The Case for Culture as a Supervisory Concern

1.2(a) Culture is viewed by some as being of relevance to the supervision of conduct risk concerns and also as a matter of significance for prudential supervisors. Is culture to be considered differently in either context? If so, how so? Or should conduct and prudential supervisors adopt a standard approach to culture as a precursor to risk considerations more generally?

Risk culture is not a “one-size-fits-all” component of Risk Management Practices for financial institutions. As already noted, risk culture, and culture overall, grows organically and is influenced by an institution's employees, including its board of directors, executive management, senior management, and staff. Risk culture is also influenced by changes in any of these roles. Elements of risk culture include, but are not limited to, values (*i.e.*, everyone is responsible for risk, “see something, say something”, etc.), code of ethics / conduct, escalation protocols, and credible challenge within and across the three lines of defense.

Having regulatory agency examiners separately assess risk culture during examinations would not be an efficient use of institution and examination resources. As stated previously, risk culture sets the overall tone of a financial institution's Risk Management Practices and will inform examiners' perceptions of how well an institution is identifying, measuring, monitoring, and controlling risks. Regulatory agency examiners can assess risk culture through examining material financial risks and evaluating Risk Management Practices, including the degree of consistency with which the firm's staff comply substantively with prescribed Risk Management Practices, versus a check-the-box examination module related to culture.

1.2 (b) Many post-mortem inquiries posit risk governance failures as having culture among their root causes. With this in view, should culture be taken to represent a source potential systemic risk? However this is answered, what implications follow?

This question seems to imply that culture can be a source of systemic risk for financial services as a whole. Systemic risk by definition involves multiple institutions, but, per the definition of “culture” posed above (*see* response to 1.1(a)), culture is highly firm-specific. A single firm's culture by itself will not create systemic risk, but its Risk Management Practices (and a culture that supports them) can mitigate potential systemic risk. The activities of one firm can have implications for risk management at others, *e.g.*, when concentrations of counterparty risk exist and raise the potential for contagion. A specific firm's risk management culture can reduce its own risk and also systemic risk by such things as counterparty risk limits and dynamic monitoring of present-value exposures, counterparty financial condition (to the extent of information available from either public sources or private, negotiated arrangements), and

general market conditions. Thus, an effective risk management culture is likely to be beneficial in mitigating overall systemic risk by reducing the chance of contagion.

As noted previously, however, firm responsibilities (to owners, customers, employees, and, in the context of legal compliance, to public authorities) are distinct from the responsibilities of supervisors. The oversight of systemic risk is ultimately a supervisory responsibility.

1.4 Legitimacy and Trust as Supervisory Assets

1.4 (a) A tension is called out through our stocktake: some value the application of experienced and nuanced supervisory judgement in the course of oversight activities, over the application of a rigid and overly prescriptive rules-based; while, on the one hand, some complain that reliance on supervisory judgement impairs the cause of transparency, consistency, and due-process. In this connection, what views do you espouse? And why?

1.4(b) How should supervisory bodies approach challenges with regard to their own organizational cultures, with a view to enable them to exercise supervisory judgement more effectively? To what extent might the culture of a supervisory agency underpin (or undermine) its perceived legitimacy? How might this shape trust in the financial sector, and its participants?

Similar to financial institutions, a supervisor's culture grows organically and is influenced over time by its leadership and employees. In the case of regulatory agencies, however, culture is also influenced by changes in wider political leadership – Congress and Presidential administrations. Political appointees under new administrations will have new priorities for the agency; however, these priorities should not significantly impact how field examiners evaluate how institutions are identifying, measuring, monitoring, and controlling material financial risks. Supervisory transparency and consistency are essential to the long-term health of the financial services industry, and, given the industry's importance in supplying credit, dependable and secure payments systems, and defense against financial wrongdoing, also to the health of the broader economy.

To avoid pendulum swings when political administrations change and maintain trust with the financial services sector, regulatory agencies could issue interagency, non-binding, principles-based supervisory guidance providing examiners with guiding markers on how to assess an institution's Risk Management Practices. The focus should be on material financial risks and provide that supervision should be tailored to the institution's product offerings, complexity, and risk profile.

We suggest the agencies seek public comment on this non-binding, principles-based supervisory guidance before finalizing it. While agencies are not required to seek comment on non-binding supervisory guidance, doing so would help produce more effective guidance by identifying relevant interpretive questions, operational challenges, and system constraints for the regulatory

agencies' consideration. We believe sound, principles-based supervisory guidance could withstand the test of time and political administration pendulum swings and maintain trust with the financial services sector.

2.1 The cost of delay

2.1 (a) With reference to the banking sector turmoil of 2023, what might be attributed to governance breakdowns, especially those related to organizational culture?

Though there are some details available from public reporting, it is questionable whether outsiders other than bank employees and supervisors have enough information to speak definitively on this question. Such reports suggest, however, that for at least one institution that failed in 2023, management of liquidity risk took insufficient account of the risk of relying on assets that, though generally liquid in nature, were accounted for as held-to-maturity, such that using them as a liquidity source would adversely affect the firm's capital position. Rather than satisfying liquidity needs, liquidation of those assets at a loss and required disclosure of the resulting capital charges made the liquidity situation acute and ultimately fatal. Moreover, alternative contingent liquidity from the Federal Reserve Bank and the Federal Home Loan Bank were likely available, but the firm's failure to make adequate operational preparations foreclosed access at the critical time.

Whether this sequence of events resulted from a poor choice of risk policies or a failure to implement policies that were adequate on their face (which failure would represent a "cultural" fault as defined in 1.1(a) above), or both, is unclear. In either case, however, a failure of risk management occurred. If firm "culture" more broadly was at fault, the key may have been insufficient weight given to liquidity risk management in the first place.

2.1(c) How should supervisors approach culture risk governance as a factor in their assessment of a firm's systems, controls, and critical risk management processes?

As stated previously, regulatory agency examiners can assess risk culture through examining material financial risks and evaluating Risk Management Practices and the consistency of their application. Examiners' evaluation of an institution's Risk Management Practice will be informed by the institution's risk culture. For example, examiners can assess an institution's issue management program to determine if the institution has timely identification, assessment, escalation, monitoring, reporting, and resolution of risk-related issues. Additionally, evaluating an institution's complaint management program will determine how the institution is defining, capturing, categorizing, escalating, reporting, and resolving consumer complaints and any associated compliance risk-related issues. Finally, an institution's internal checks and balances (or "self-policing"), such as monitoring and testing activities, effective challenge, risk reporting, and internal audits, will also help examiners evaluate how well institutions are identifying, measuring, monitoring, and controlling material financial risks.

2.2 The anatomy of structured discretion.

2.2 (a) How should supervisors balance establishing evidence of wrongdoing before they take action versus exercising supervisory judgement to preempt problems from happening in the first place? How does the necessary posture differ based on legal mandate and supervisory tools?

The best way for supervisors to identify if an institution has undue risks and weak risk management practices is through the examination process, including a clear, concise written report of examination and on-going communication with the management team. Safety and soundness examination activities focus on assessing an institution's capital, asset quality, management, earnings performance, liquidity, and sensitivity to market risk (e.g., CAMELS rating system), as well as the institution's adherence to laws and regulations.

If asked what the hardest report of examination for an examiner is to write and for an institution to receive, the answer, in most instances, would be a Composite 3-rated report of examination report. Examination reports of fundamentally sound institutions with strong or satisfactory risk management practices (Composite 1 or 2) or institutions exhibiting unsafe or unsound conditions or practices (Composite 4 or 5) can practically write themselves as the evidence to support those ratings is apparent. In cases of a well-rated institution, the management team is receptive to the findings – who would refute being told your institution is well-run and safe and sound? For a problem bank, the management team may be in denial but typically will not be able to refute the evidence, such as the level and severity of classified assets and the impact on capital levels, earnings performance, and other factors. Bank failure is a distinct possibility (Composite 4) or highly probable (Composite 5).

An institution, however, with a Composite 3 rating, may be hearing for the first time (and by the same examination team) that the institution has some weakness, is not “well run”, and will be under some type of supervisory action. A Composite 3-rated institution exhibits supervisory concern in one or more CAMELS components, as well as associated Risk Management Practices, and may be more vulnerable to outside stresses and business fluctuations than a well-rated institution. Therefore, a 3-rated institution is at a crossroads, and its financial condition and operational/risk management practices will either improve or continue to deteriorate over time. Which road to take falls on the management team and its board of directors to decide.

2.2 (b) How should supervisory bodies address accusations that they tend towards overreach, on the one hand, versus overly delayed action, on the other?

With changes in economic conditions or political administrations, one constant should remain the same – the examination process including a clear, concise written report of examination and on-going communication with the management team. An effective regulatory framework should focus on material financial risks with an institution's Risk Management Practices being an essential aspect to this framework. Financial institutions should be able to determine their risk

appetite and strategy and develop Risk Management Practices based on their size, complexity, and product offerings. The examiner's main objective in an effective supervisory framework is to determine how well a financial institution identifies, measures, monitors, and controls material financial risks given their size, complexity, and product offerings. The leaders of supervisory agencies may change, along with their priorities for the agency, but the basic blocking and tackling of examinations should not change. And, open, ongoing communication during the examination process is not only essential but should be required by both parties.

2.2 (c) How might supervisory bodies work to establish greater trust with regulated entities?

Communication is a two-way street. Throughout the examination process, ongoing, open communication between examiners and an institution's management team is imperative, especially with hybrid examinations (e.g., partial time on and off site). In addition, reports of examinations should clearly and concisely identify the issues, clarify the impacts, be fact-based, and relate to the law or clearly articulated supervisory expectations. An institution's management team should be able to leverage the report of examination to determine the root cause of the issues and implement appropriate corrective action plans. It is important that both parties, the institution and supervisors, are on the same page as to what issues need to be corrected; however, it is up to the institution to determine the most effective way to correct the identified issues.

2.3 Proportionate early action.

2.3 (c) What is the appropriate role for enforcement in addressing culture as sitting among the root causes of risk governance failures?

Postmortems of recent bank failures noted that the institutions had rapid growth without commensurate risk management practices. In addition, these postmortems have shown that stronger regulatory frameworks were needed to make sure supervisors take the appropriate action to ensure institutions addressed supervisory concerns in a timely manner.

Supervisors have the necessary tools, including informal (e.g., supervisory letters, board resolutions, memoranda of understanding) and formal (i.e., cease-and-desist orders, consent orders, written agreements, and removal/prohibition orders) supervisory actions, to ensure that institutions' Risk Management Practices are commensurate with their size, complexity, and risk profile and that policies and procedures are consistently applied. Provisions in informal or formal supervisory actions are often written as programmatic changes and may not address the root cause of the issue. For example, provisions typically include, but are not limited to, the following: increasing board of directors and management oversight; reducing classified assets; reviewing and revising a specific policy or program; maintaining certain ratios such as capital or liquidity; remediating violations of law; and developing a strategic plan. These provisions, however, serve as a "roadmap" for institutions to remedy issues identified in reports of examination.

This is where risk culture comes into play and where the “rubber meets the road.” Institutions that are successful in remediating a formal or informal supervisory action quickly, identify the root cause of the supervisory concern, develop an appropriate and timely action plan, and, most importantly, implement the necessary operational changes to remediate the root cause. Institutions that remain under supervisory actions for long periods of time, however, tend to think about compliance with the supervisory action as a check-the-box exercise to simply get out from under it by addressing the programmatic changes without implementing the necessary operational changes to address the root cause.

3.1 Integration into Supervision

3.1 (a) Should supervisors embrace culture risk supervision as a means by which to prevent future crises, and how would that change how they approach supervision? What steps would you recommend that supervisory bodies take to ensure that efforts to incorporate culture risk supervision into supervisory frameworks are sustainable over time.

Through various economic cycles and political administration changes, one constant should remain the same for financial institutions – sound Risk Management Practices. During various economic and political changes, institutions should continually ask, “are we proactively identifying, measuring, monitoring, and controlling risks?” Consistently having a “risk-management” mindset and embracing the practice of “self-policing” (i.e., monitoring and testing activities, effective challenge, and internal audits) will help ensure institutions longevity through economic downturns and/or administration changes.

As stated previously, regulatory agency examiners can assess risk culture through examining material financial risks and evaluating Risk Management Practices associated with such risks. We believe it would not be an efficient use of institution and examination resources to have examiners separately assess culture under a check-the-box examination module, though an assessment of consistency of implementation of Risk Management Practices is appropriate. Examiners’ evaluation of an institution’s Risk Management Practice will be informed by the institution’s risk culture.

3.3 Supervisory learnings to date

3.3 (a) What examples of successes in frameworks and governance processes can the industry point to in the area of culture risk governance and supervision?

One specific effort that has demonstrated significant progress since the 2008 financial crisis is the evolution in firms’ approach to managing incentive compensation, particularly compensation for employees in positions most likely to expose the firm to risk.⁵ As management of the

⁵ Note that the universe of employees, if thought of in terms of job descriptions and responsibilities, that can expose a firm to a given degree of risk is not a static concept, and certainly not a static list. Those who directly commit firm

complex of risks to which financial services firms are routinely exposed has gained greater attention, both firm boards and managers and government supervisors have focused on policies addressing the degree to which incentive compensation can reinforce or hinder effective risk management. Since effective acquisition and retention of appropriate staff (of which compensation schemes are a critical part) is key to a firm's success, it has appropriately fallen first to senior management to develop an effective and prudent approach. With heightened scrutiny since the 2008 financial crisis, supervisors have carefully reviewed and discussed incentive compensation schemes with management, especially at the largest firms, including those considered systemically important.

4.1 The risk of regulatory drift

4.1 (a) What is needed to ensure that culture risk supervision becomes a durably embedded and routinized feature of supervisory regimes, rather than a secondary or transient concern?

See response to 3.1.(a) above.

4.1 (b) What structural, political, or institutional barriers have hindered progress on developing sound protocols for culture risk governance and supervision? What conditions are needed to overcome them?

As stated previously, ABA recommends that the supervisory agencies issue interagency, non-binding, principles-based supervisory guidance providing examiners with guiding markers on how to assess an institution's Risk Management Practices. The focus should be on material financial risks and provide that supervision should be tailored to the institution's size, complexity, and risk profile. Recognizing differences among the institutions the supervisory agencies examine – community banks, mid-sized financial institutions, and larger, more complex financial intuitions – ABA acknowledges that developing interagency guidance would be challenging and will require careful tailoring.⁶ However, providing principles-based guidance will provide financial institutions with a starting point in developing or enhancing their Risk Management Practices.

capital, e.g., traders and investment managers, were a particular focus after 2008, but information technology managers, marketing or legal staff, business continuity managers, and a host of others can either bring risk upon the firm or must be accountable for keeping risks within the firm's appetite.

⁶ The Office of the Comptroller of the Currency (OCC) issued a notice of proposed rulemaking (Proposal) to amend its guidelines relating to heightened standards for insured national banks, insured Federal savings associations, and insured Federal branches (Guidelines). In the Proposal the OCC acknowledges that the Guidelines, as currently formulated, establish overly prescriptive standards for banking organizations' design and implementation of a risk governance framework and how boards of directors must carry out their oversight responsibilities. ABA recommended the OCC rescind the Guidelines, or in the alternative, to revise and replace the Guidelines with nonbinding, principles-based supervisory guidance.

4.2 The imperative of innovation

4.2 (a) What enabling conditions can foster innovation — within supervisory bodies and among firms alike to help accelerate the development, testing, and adoption of new tools, metrics, and practices for addressing culture-driven risks?

Can innovation – new tools and metrics – give supervisors a better sense of an institution’s culture? As part of an examination, supervisors review strategic plans, risk appetite statements, policies and procedures, Risk Management Practices, committee and board minutes, incentive compensation and performance management programs, and various reports and dashboards. Through this review examiners try to figure out if the institution’s practices align with policies and procedures – basically, are the institution’s employees really doing what their frameworks, programs, and policy documents say they should be doing? Are examiners, however, getting a sense of what the firm’s culture truly is just by reading documents and reviewing metrics in reports and dashboards?

For example, examiners can review loan committee minutes to see if any loan policy exceptions were discussed or if any “effective challenge” took place; however, that will depend on what was documented in the minutes. Examiners have loan discussions with management and senior lending officers, but those conversations typically focus on individual credit relationships and any adverse classification. Examiners may also review an institution’s incentive compensation program, but most likely focus on compliance with outstanding interagency guidelines.⁷ This is well and good, but will the examiners have a true sense of what activities are really being awarded? Examiners could interview an institution’s employees and ask probing open-ended questions to get more details; however, how open and transparent will an employee be to an exam team to help them understand the institution’s culture?

The question for supervisors is how best to train examiners to understand an institution’s risk culture efficiently and effectively beyond written documents and various metrics? And, how does an examination team determine what the institution truly values? It is one thing to read a strategic plan, an incentive compensation program, and a loan policy for compliance with laws, regulations, and supervisory guidance. But, it is a completely different thing to connect what is written in these documents to what an institution’s employees are actually doing to determine its culture. It gets even harder when examinations are moving to hybrid and spending less time on site.

Pointing out the challenges of this aspect of supervision is not to say that they are insurmountable, and certainly not that the question is unimportant. These concerns do, however, underscore the modesty and circumspection with which supervisors should attempt to define the role of an institution’s culture in the supervisory process.

⁷ See Guidance on Sound Incentive Compensation Policies published at *Federal Register*, Vol 75 No. 122, 36395 (June 25, 2010).

4.2 (c) What barriers do firms face in evaluating, testing, and implementing new tools or innovative governance frameworks for addressing culture risk governance?

Firms need to stress alignment among risk management policies and business practices, *e.g.*, assuring that risk management considerations receive appropriate consideration alongside opportunities for increased sales, revenue generation, etc. Important elements are hiring and compensating risk managers as well as first-line managers and personnel and compensating and promoting staff consistent with stated risk management policies in addition to achievement of other business metrics. Moreover, the firm should make clear that risk management is part of everyone's job description in appropriate ways, and management should train and mentor more junior staff in appropriately balancing returns and risk.

In addition, after prescribing all the appropriate elements, firms must establish means of confirming consistent performance. Aligned behavior should be confirmed in day-to-day management oversight of employees, through performance evaluations and informal feedback, and, as noted, through aligned compensation and promotion. Staff should see that rewards accrue from the behavior, including risk sensitivity and controls, that the firm says it desires. It is axiomatic that staff will observe any inconsistencies and adapt to what the firm actually rewards. Management must develop methods appropriate to the specific firm to confirm that its directions are followed.

4.3 The need for a common evidentiary basis for decision-making regarding culture

4.3 (a) What kinds of tools, processes, or evidence trails might help to enable boards and executives to demonstrate credibly that a firm's cultural dynamics are aligned with its governance structures, business model, and risk tolerance?

The answer to this question is necessarily highly firm-specific. As noted in 4.2(c), however, management can be vigilant in aligning compensation and other personnel decisions with the behaviors it requires of staff. Tracking compliance with risk limits, *e.g.*, violations of trading position or exposure limits, can identify failures of risk governance (specifically, behavior inconsistent with policies, thus cultural failures as defined, at least when the failures are persistent) before actual losses occur. Tracking such instances with reporting to senior management, including managers outside the specific first-line function in question, are commonly used processes to demonstrate to what extent the culture of risk management and compliance is effective.

Also relevant to compliance, but transcending it, is monitoring of customer and vendor/counterparty complaints and other performance issues. An employee compliance hotline or second channel through which concerns (whether about management of material financial risk or something else) reach senior management are also useful early warning tools. As noted earlier, some but not all cultural concerns are appropriate subjects of supervisory interest, and channels like these can capture those as well as others of concern to management.

4.3 (b) How might the industry and supervisory bodies come together to establish a common evidentiary basis for assessing culture risk governance?

In most if not all of the issues ABA has addressed, the first response is the responsibility of firm management. When management addresses risk management, compliance, reputation, and brand, supervisors can assess the subset of those issues appropriate for their consideration and review the consistency of the firm's actual operations and results with its stated principles.

4.4 The case for global collaboration

4.4 (a) What is the ideal forum for encouraging public and private sector participants to work together in an effort to reach consensus around common approaches to culture risk governance and supervision? What factors need to be in place to support success in that direction?

In theory a global consensus may sound desirable. Though global collaboration has produced many useful innovations in financial regulation and supervision, *e.g.*, the Basel Committee on Bank Supervision, it does not include private-sector participants.⁸ Moreover, in addressing supervision of risk management governance, it is essential to keep in mind not only that each firm has specific needs and standards for addressing them, but also that global financial services markets are highly diverse, and both institutional structures and supervisory regimes differ significantly across those markets. Thus, a single approach is unlikely to work well across markets, and different concerns will likely arise from one to another.

At the same time, globally active firms must not face undue burdens from conflicting national supervisory standards. Markets are highly efficient channels for moving capital and allocating credit, and erecting barriers in one sector (such as regulated financial institutions) will quickly lead to changes in flows, including movement of financial activity outside the regulated and supervised part of the market altogether. The ultimate goal of effective risk management therefore again requires a careful balance.

⁸ It does, however, routinely propose draft policy positions and draft regulatory text for public comment.

ABA appreciates the opportunity to share thoughts on these matters. Should you wish to discuss anything further, please do not hesitate to contact the undersigned.

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