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Disclaimer: these comments are provided by EBF staff upon their own observation and experience and do not necessarily represent the diverse views and situations of EBF member banks

EBF comments on Starling Insights' Supervisors on Supervision

Dear Mr Scott, dear Stephen,

We welcome the exercise launched and coordinated by Starling Insights on a *Deeper Dive of Supervisors on Supervision*. We appreciate such a comprehensive recollection of insight from the leaders of the worldwide supervisory community who accumulate an unparalleled knowledge base on the banking system from the supervisory perspective.

We appreciate the opportunity to comment on the draft report before publication of the final version. Our contribution will target certain questions where the standpoint of banks will surely be of interest.

We understand that every crisis shows lessons to be learnt. The reflections on culture of this exercise are pertinent after the 2023 bank crisis. Nevertheless, we would like to point out that such crisis was limited in scope affecting only 4 banks in the US and 1 in Switzerland. The first lesson learnt was about the high resilience of the international banking system following the regulatory reform which impeded risk contagion and widespread fear across the entire banking sector. Such resilience has been built around quantitative prudential measures since the beginning of the regulatory reform post-GFC like the enhancement in the quality and quantity of capital and the adoption of international liquidity standards, but it is also the result of strengthened governance in the banking sector. The fact that only a few banks had a weak set or a lack of governance standards is an opportunity to reflect upon those individual deficiencies, but it should not be a reason to extrapolate disproportionate new requirements to the entire sector.

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Bank supervision has traditionally been based on quantitative data and analysis. This Starling Insights' exercise delves into more qualitative aspects of supervision, in particular the capacity of the supervisor to perceive and understand the internal characteristics and circumstances surrounding the bank under examination, commonly packed within the term of "culture".

Gregorio Marañón¹ (1887-1960), eminent physician and humanist, was once asked which was the most important tool in medicine for diagnosis and treatment. His answer was "the chair". The chair the doctor sits on to listen with empathy to the person being examined in order to understand his or her history, circumstances and habits. In his view, this was essential to complement medical data and numerical indicators.

Likewise, greater supervisory understanding of the bank's culture will require observing and listening to the bank, assessing its trajectory, circumstances and patterns rather than articulating prescriptive rules or guidelines for a supervisory score of culture.

Principles for risk culture supervision

In the face of multiple ideas about the role of risk culture and whether and how it should be integrated in supervision, it will be important to avoid disparate initiatives and fragmentation by keeping a close coordination across jurisdictions.

For that purpose, it would be wise and efficient to build on the existing framework which already provides the bedrock for risk culture supervision within the Basel Committee principles² updated after the 2023 crises. There are two facets of culture covered by the BCBS principles: firstly, the supervisor should check the risk culture itself which refers to a bank's norms, attitudes and behaviours related to risk awareness, risk-taking and risk management, and controls that shape decisions on risks. Risk culture influences the decisions of management and employees during their day-to-day activities and has an impact on the risks they assume. Secondly, the supervisor should check that the bank management communicates the corporate culture and values which could be implemented through a code of conduct.

Those principles have already been adopted in some jurisdictions earlier than the burst of the 2023 crisis. For instance, from the takeover of supervisory responsibilities, the ECB Single Supervisory Mechanism (SSM) expected

¹ Starling's "Supervisors on Supervision" resembles Marañón's "La medicina y los médicos" (Medicine and Physicians), a series of essays on the relationship between science and humanism

² [BCBS Core Principles for Effective Banking Supervision](#)

bank Boards to challenge, approve and oversee the management's implementation of the bank's strategic objectives, governance and corporate culture³. As recalled by Claudia Buch in her contribution to Starling Insights, the ECB expects that banks facilitate a culture of effective communication and challenge at all levels, from the management body and senior management to the staff, to strengthen the ability to openly and constructively challenge decisions.

Culture risk

While risk culture is a measurable concept based on international principles, culture risk is a more ambiguous definition. As Sir John Kay explains in the preamble to chapter one of the draft report, culture is *a kind of non-financial residue, attributed to tone, morale, or employee engagement*. In our opinion, these attributes cannot be subject to supervisory compliance. They should be mere factors that inform qualitative aspects of the wider supervisory assessment.

Evaluating culture risk is more an art than a science. An experienced supervisor does not only read financial reporting but uses it to check information with bank employees across departments gaining understanding by joining the dots without crippling the organization with additional requests or formal surveys.

We would like to remind culture is not a risk in itself but a factor that could eventually translate into financial risk with varying degrees of severity. Culture could also represent a strength for a credit institution, not only necessarily a risk. The supervisory assessment of culture should be based on observation and supported by evidence of deficiencies in internal controls and structural lines of defense.

Improving the use of the current framework

Supervisors should focus on making proper use of the tools at hand. The individual bank failures of 2023 showed deficiencies or absence of lines of defense and savvy supervisory oversight. Strengthening internal controls, enhancing senior management understanding and reinforcing supervisory oversight would either have prevented those failures or have made them more predictable for the supervisor, therefore better manageable at an earlier stage for all involved.

³ [SSM supervisory statement on governance and risk appetite](#)

In this regard, we would highlight Stephen Scott's allusion to Jonathan Gould's speech⁴ in the executive summary of the report. We agree that regulators should refocus bank supervisors on material risks rather than engaging in check-the-box exercises. As Andrea Enria pointed out *supervisors are overwhelmed by tasks linked with checking compliance with a very complex regulatory framework, which leaves very little time for focusing on cultural issues*. We are of the view that culture should be considered a driver of weakness or strength of the financial institution within the current framework and that requires space for the supervisor to observe the bank as well as capacity to assimilate the signs into the overall judgment. As Professor Amy Edmondson suggests, we should see *culture not as an outcome to be audited but as a system condition to be examined in vivo*.

Prescription of rule-based schemes to reflect the culture of the firm would be a cumbersome exercise for banks and it would likely miss the whole point about cultural features that could translate into financial risks. Instead, supervisors should focus on the existence of sufficient controls so that any deficiency that culture risk might produce will be detected and remedied before developing into financial risk. Also, a strong culture should be reflected in the supervisory assessment. We believe that the resilience of many banks is anchored to strong cultural values.

Limits to supervisory interference

Firm culture or values should not be judged right or wrong by supervisors. They can only be taken into account as factors that could translate into financial risks. The observation process of the supervisor should include cultural aspects without interfering into banks' decision-making and business strategy which fall within the remit of the bank Board of directors following the strategic direction set by owners or shareholders.

Quality of supervision

No prescriptive framework can replace the experience of supervision. We would like to underline Sir John Kay's observation that *what makes a supervisor effective is rarely written down, but it lies in the interpretive reflexes of experienced examiners, the judgment shared between colleagues who have seen a failure unfold before, the memory of lessons learned that subtly shapes how new risks are viewed. These things cannot be manufactured on demand*.

In this vein, we think that supervisors should care about the transmission of legacy experience from one generation to the following one. The younger

⁴ [American Banker article "OCC's Gould vows to refocus bank supervision"](#)

supervisors post-GFC are overwhelmed with compliance tasks due to the complexity of the current regulatory framework, especially in some jurisdictions. We should simplify the framework, passing knowledge and experience from seasoned supervisors to the next generation and ensuring that supervisors have experience on the ground which is necessary to soak up the atmosphere of banks' culture.

Way forward

We strongly support continuous collaboration between supervisors, industry and professional bodies. Sharing international perspectives, best practices, and lessons learned would be beneficial to all.

We encourage supervisors to count on the involvement of banks on the potential design of policies to assess aspects of culture in the supervised banks.