TC Webinar Series: Revised Core Principles for effective banking supervision

Part 3: Risk Management and Business Model Sustainability

Panelists:

Elsie Addo Awadzi

Deputy Governor, Bank of Ghana; Board Member, Toronto Centre

William Burn

Managing Director, Supervision Methods, Standards and Controls, Office of the Superintendent of Financial Institutions (OSFI), Canada

Moderator:

Clive Briault

Chair, Banking Advisory Board, Toronto Centre

Date:

July 17, 2024

Transcript:

Clive Briault:

Good morning, good afternoon, and good evening, everyone, wherever you are. Many thanks indeed for joining us today and welcome to this, the third webinar in the Toronto Centre series of webinars on the revised Basel Core Principles. I think we have more than 400 people registered for this webinar from 73 countries. I hope as many of them as possible are able to join us today. My name is Clive Briault and I'm chair of the Toronto Centre Banking Advisory Board.

Since its establishment in 1998, Toronto Centre has trained more than 26,000 financial supervisors from 190 countries and territories to build more stable, resilient and inclusive financial systems. The Toronto Centre's mission is sponsored by Global Affairs Canada, the Swedish Sida, the IMF, and other valued international partners. Today, we're going to focus on Risk Management and Business Model Sustainability. These areas, the revisions to the Basel Core Principles, published in April this year, place greater emphasis on banks' corporate culture and values as a key element of a strong risk management practices. They also cover, for the first time, the need for banks to adopt and implement sustainable business models and for supervisors to assess business model sustainability.

To discuss these important issues, I'm delighted to welcome our two speakers today who I'm sure will bring a wealth of insights and expertise. Elsie Addo Awadzi is Deputy Governor of the Bank of Ghana and a Board Member of the Toronto Centre. Will Burn is Managing Director of Supervision Methods, Standards and Controls at the Office of the Superintendent of Financial Institutions (OSFI) in Canada. Their full biographies can be found in the registration pack for this webinar.

We're going to run this webinar in two parts: the first focusing on culture and values, and the second on business model sustainability. Our speakers will open each part and then there will be some time to answer as many of your questions as we possibly can. So, do please send in your questions as we go along using the question-and-answer function on your Zoom screen. In case you haven't already noticed, we are offering translation of this webinar into both French and Spanish, but I would be grateful if you could possibly ask your questions in English.

> An institution's culture can influence decision making and its risk taking, and that means that culture can materially support or alternatively weaken the resilience of regulated institutions, especially in fast moving and uncertain risk environments.
>
> **William Burn**
> Office of the Superintendent of Financial Institutions

I'm going to ask Will to open the discussion on culture and values, placing this within the wider context of good risk management. He, and then Elsie, will also cover their experiences supervising the culture and values of financial institutions in their respective jurisdictions, and the measures that supervisors can take that may lead to stronger culture and values within financial institutions.

So, Will, over to you first, please.

William Burn:

Thank you, Clive. I'm very happy to be here today for the conversation with you and Elsie, and I'm looking forward to the questions that we'll get from participants.

An institution's culture can influence decision making and its risk taking, and that means that culture can materially support or alternatively weaken the resilience of regulated institutions, especially in fast moving and uncertain risk environments. At OSFI, we've always recognized the critical role played by the Board of Directors and the centrality of effective risk governance in achieving sound, prudent supervisory outcomes. Ultimately, it's the board that's responsible for an organizational culture that underpins the success of risk owners and oversight functions, and there isn't an ideal culture. Sound culture depends, to some extent, on context, but that said, all cultures should reflect a commitment to norms that encourage ethical behavior.

OSFI has a draft guideline on culture and behavior risk, and according to that guideline, we expect institutions to define their desired culture and then continuously evaluate and respond to behavior risks that could impact overall safety and soundness. So, in other words, culture

should be deliberately shaped, evaluated and maintained. We're starting to see that culture and other non-financial risks are better integrated into institutions' risk management frameworks. Boards are paying more attention to the role of culture in influencing risk-taking behavior.

I'd like to talk briefly about incentives and accountability. Incentives are a very important part of the culture equation because compensation is a powerful tool to encourage the right risk behaviors and also discourage the wrong ones. In Canada, so far, we've taken a principles-based approach to compensation reform, consistent with our broader approach to prudential regulation.

Turning to accountability, which also underpins effective risk culture, as part of our new supervisory framework that became effective in April of this year, we're communicating additional information to institutions to provide them with greater clarity about risks and desired outcomes. We're finding that this clarity is helping equip boards to ask tough questions of their senior management teams and hold them accountable.

So, to sum up, it's a combination of incentive structures and accountability measures that you need to support effective risk management, and I'd like briefly just mention a speech that our Deputy Superintendent, Ben Gully, gave last month. The title of that speech was Promoting Effective Risk Governance: No Time for Complacency. In that speech, Ben went into much more detail about risk governance, including the top 10 behaviors and tendencies that we see in effective boards of directors. I'll put a link in the chat in a moment.

Over to you, Clive.

Clive Briault:

Okay, well, thank you very much for those introductory remarks, Will. Over at this point to Elsie to add her thoughts on cultural values, but just in the meantime, as far as I can see on my screen, no one's yet put a question up. So, if you do want to ask questions of our illustrious panelists today, do please put your questions in the Q&A box on Zoom.

Elsie, over to you please. Thank you.

Elsie Addo Awadzi:

Thank you, Clive, and thanks for having me for this very important conversation. Good to be here with yourself and Will.

As you said, culture and values, and as Will said, have become really important parts of overall risk governance and risk management of any regulated financial institution. We at Bank of Ghana, strongly believe that. We believe that for supervisors, this is increasingly becoming very important, although we see challenges there also: supervisors traditionally have been trained to look at numbers, right? Basically, quantitative metrics have been very important in supervision, so if a bank has the right kind of capital adequacy ratio, perhaps non-performing loan (NPLs) are in the range where you want them to be, and profitability is where you want it to be, you tend to gloss over what the story is behind those numbers. Sometimes, the numbers don't look as good, but supervisors in the past had not probed further or interrogated those numbers to understand what really the underlying cultural and value systems at play are.

And so, we've taken a very critical look at this and are enabling our supervisors to begin to have conversations with banks to better understand the stories behind the numbers and really how banks are positioning themselves in terms of culture and values to drive the numbers that we're seeing, for good and for bad. Underlying all of this is the fact that we're taking a more long-term view to say, let's understand how these value systems and these cultural norms and practices in the end help to build safe and sound institutions or otherwise, and let's do something about it while we can, to reshape these conditions.

> We are enabling our supervisors to begin to have conversations with banks to better understand the stories behind the numbers and really how banks are positioning themselves in terms of culture and values to drive the numbers that we're seeing.
>
> **Elsie Addo Awadzi**
> Bank of Ghana

And so, some of the things that we've been interested in looking at has been, as Will said, risk, excessive risk taking, and basically understanding how banks are lending, what's the -culture when it comes to how bank executives are remunerated and how that might incentivize one kind of culture or value system or the other, how banks are reporting themselves; are they being truthful in their reporting? Is there a culture of sweeping things under the carpet until it's too late? What are the banks' own internal early warning systems for picking up things that don't seem right, and how are these percolated up? Is there a whistleblower system in place? How are whistleblowers treated in the end, etc.?

Consumer protection is also one thing that we look at very carefully: how are customers of the bank treated? What is the value system and the culture around how customers are treated, all sorts of customers. And along these lines, we are also very much promoting environmental, social, and governance (ESG) principles that include inclusion. Financial inclusion is a big imperative for us as well because half of the population is outside the banking system, but that sometimes is a result of a customer operating in the informal sector, operating a small business, walking up to a bank branch and not getting access to a bank account even though they may have all of the documentation in place; just because you're treated as well, you're too small to matter to us, we don't really care about you, and stuff like that. This also leads to unfair pricing of products and services, lack of transparency in lending agreements, and even how customer accounts are charged fees and all of that.

So basically, we look at this from all these angles, again, looking at it from the role of the boards and how they set the tone at the top, but also how even at the branch level, these values and cultures are playing out. And so, our supervisors are empowered not only to deal with the top, but also to deal at every level. As we go along, I'll share a bit more specifics as to some of our experiences. Thank you.

Clive Briault:

Yeah. Well, thank you very much indeed, Elsie. Also, thanks to Will. He has put a link up in the chat function to a speech by Ben Gully, that he mentioned. I'm pleased to see that we do now

have a question in the Q&A and it's from Richa, who is a Program Director at the Toronto Centre. She's posed it as a question to Will, but I think it's also equally relevant to Elsie and covers some of her remarks about the board. And the question was, really, how can boards prevent excessive risk-taking and aggressive selling practices by financial institutions? Perhaps we might just broaden out the question a little bit so it's not just about how can boards do that, but how would you expect a supervisor to know and discover whether or not a board is actually doing the right thing here? So, Will, I think over to you first, please.

William Burn:

I think it comes 'round to risk governance around policies and procedures for undertaking business and making sure that there's a balanced performance scorecard for staff, so that they're not unduly pursuing growth over other considerations.

Clive Briault:

Okay, thank you, and just to feed on from that, as to what you would expect supervisors therefore to be looking at, to assess whether that's really happening or not.

William Burn:

I think it's comparing what they're seeing in terms of performance, and this is an interesting question because there's a segue between the two topics that we're talking about today. So, there's business risk and risk management, and this is touching on both of them, but what has the board approved strategy and plan, and then compare that performance and understanding of how things are diverging and whether the performance of the institution is aligned with the strategy that has been approved.

Clive Briault:

Okay, thanks, Will. Elsie, anything you wanted to add to that? You mentioned in your remarks that you expected your supervisors to be having conversations with members of the board and senior management. So, what do you think they should be looking for in terms of how the board can prevent excessive risk taking and aggressive selling practices?

Elsie Addo Awadzi:

Sure, so I totally agree with Will. I think the bank's strategy is one place to look at, what are the goals the bank itself has set? Are these reasonable? Are these practical? So, that's number one. Remuneration policy is also a big giveaway. And performance appraisal systems: what are people held accountable for and what are the expectations of staff members? Because sometimes I find that excessive selling and stuff like that really has even been done either on the blind side of management or the board, but just because people are being held to very high targets and stuff like that. The board cannot say they don't understand that targets that are set that are unrealistic will lead to such behavior. And so, you want to look at how people are assessed for what kind of performance and how that leads to remuneration policy, what gets rewarded, basically.

The other thing I want to stress has to do with the fact that sometimes we have seen here that high staff turnover is a big indicator, and we were seeing in the case of a few banks, excessive

staff turnover. As we began to investigate and interrogate, we realized that a lot of staff members were getting burnt out because they were being forced to meet extraordinary targets; you need to increase deposits by so much in a particular month, you need to increase loan lending portfolios by so much, you need to increase this portfolio by so much, profits must go to this level... all of these are totally unrealistic. But, what this means is that staff members that then are on their own to devise their own individual strategies to try and meet these targets, eventually some of them who cannot do it will just quit. Those who stay might then be adopting all sorts of strategies that are not clearly aligned with overall corporate strategy. But you cannot call it an unintended consequence, anyhow.

So yes, the boards and senior management must be very aware of intended and unintended consequences of strategy and targets and performance metrics.

As we've developed our approach around culture and behavior risk, what we've been looking for are insights that can be actioned by supervisors. That's important because we're so evidence-based and we're wanting to engage with institutions and be clear about the outcomes that we're looking for.

William Burn
Office of the Superintendent of Financial Institutions

Clive Briault:

Okay. Thank you very much for that, Elsie. We have another question from Sarah asking how supervisors can best collect and collate the qualitative information that you've both been talking about. And interestingly not just for internal risk assessment purposes, but also whether you publish any of those observations in any way, perhaps as a published thematic review of what you are seeing across your financial institutions. Perhaps it might also be the case, Will, that the draft guidance that OSFI has been working on cultural behaviors, although not explicitly related back to what you see in the firms you supervise, I imagine that actually that guidance is based in part on what you've observed over the years around culture and behaviors. So, I don't know which aspects of that you want to touch on... I think I've turned a couple of parts of a question into about three parts, sorry to confuse. But Will, do you want to take that one first?

William Burn:

Thank you. It's a very interesting question. As we've developed our approach around culture and behavior risk, what we've been looking for are insights that can be actioned by supervisors. That's important because we're so evidence-based and we're wanting to engage with institutions and be clear about the outcomes that we're looking for, and one of the things that's helped us as we approach that work is to develop a taxonomy of cultural risk that supports internal discussions about observations that we've seen and then focus on the outcomes that we're looking for with institutions.

So perhaps for an example, we're careful to avoid promoting any single type of culture, but we might be doing work in a particular area, say for credit risk. And the findings, that we have in

that scenario when we look at them, our conclusion might be that they relate to an element of culture risk, perhaps that there's a lack of vigilance in the way that the business is being carried out or there's a fear of speaking up amongst the staff and then we can call attention to that.

Clive Briault:

Okay, thank you very much, Will. Elsie, any thoughts on that? You've said in your remarks, but you were going to offer a few more observations about what actually happens at the front line when supervisors assess these things and feed it into the risk framework. So, anything you want to add?

Elsie Addo Awadzi:

Yeah. So unlike OSFI, we have not published a taxonomy, per se, that would help with these conversations, but I think that's a brilliant idea. What we've done is issue a number of directives to banks, including corporate governance directives, which embed requirements for improving corporate culture and values. We published a corporate governance disclosure requirement, that also has banks reporting specifically on what they're including in their codes of conduct for all levels of staff and their board members and et cetera, so we hold them accountable to those.

And then, we look at customer complaints, we collect or collate all sorts of data points on customer complaints because banks are required to tell us when they receive customer complaints. And sometimes the customers come to us directly; we have a dispute resolution function. And so, we're also able to collate these and sometimes publish some of these, and then fraud reports as well. All of these give us a picture of what's going on, and as Will said, when we look at the numbers, non-performing loan numbers, we're able to tell what the level of risk governance around credit underwriting is. When we look at excessive growth in revenue lines, it's all relative, but if you compare year-on-year, quarter on quarter, we're able to trigger some conversations to say what's under underlying these and what's at play. And so, it's a combination of things, we don't have a hardwired formula for this, but increasingly, it's about judgment and it's about some very clear parameters that the banks know that we engage with them on.

Clive Briault:

Okay, thank you very much for those responses, Will and Elsie. Another question has appeared from someone who prefers to remain anonymous, but basically saying your answers make very good sense, obviously, in the case of banks and other financial institutions headquartered in your jurisdiction, but what about the action of branches operating in your jurisdiction where you may not have a board of directors to focus on? Elsie, do you want to comment on that first?

Elsie Addo Awadzi:

I will, and it's pretty easy because all operations of foreign banks here are organized as subsidiaries. It's a basic requirement of our banking framework, so it makes things a little easier for us. But even there, what we realize is that you tend to see a different kind of culture; it could be very different depending on whether you're dealing with a subsidiary of a foreign bank versus dealing with a domestic bank, or if you're dealing with a state-owned bank, for example, or a bank that is listed on the stock exchange versus one that is not. I mean, the conversations

around culture and values can be quite nuanced and it becomes quite evident which organization you're dealing with depending on what you're seeing. So yes, we see differences, but we regulate and supervise them all the same because they're all subsidiaries.

Clive Briault:

Okay, thank you. Will, any comments on branches quickly and then we'll move on?

William Burn:

Our approach is quite different for branches because they're not legal entities. So, the approach is different for branches. There are specific expectations, but it's a different approach for branches.

The conversations around culture and values can be quite nuanced and it becomes quite evident which organization you're dealing with depending on what you're seeing.

Elsie Addo Awadzi

Bank of Ghana

Clive Briault:

Okay. All right, thank you. One more question come up from Sylviano asking if one way of trying to get some information on culture and values and, indeed, probably other aspects of a firm's behavior would be to have a supervisor sitting on the board of a systemically important financial institution. What do you think about that idea, Will?

William Burn:

The difficulty there is the loss of independence that would happen. So, I don't think we would be supportive of the supervisor sitting on the board. We wouldn't be.

Clive Briault:

Okay. Loss of whose independence, Will? Can you just clarify

William Burn:

The loss of the supervisor's independence if they were participating in the oversight of the institution directly.

Clive Briault:

Okay, thank you. Elsie?

Elsie Addo Awadzi:

I agree. I agree with Will. Totally.

Clive Briault:

Okay. There's a couple of questions that actually appeared in the chat, so I'm keeping an eye on that as well as the Q&A. One of them is actually around something you mentioned, Elsie, ESG, basically saying there's quite a lot of confusion about what exactly that means and how

exactly it's assessed, therefore asking whether there might be scope for entities to collaborate to provide the market with a bit more guidance to overcome some of the miscommunication and inconsistencies around those terms, which undoubtedly arises. Elsie, did you want to comment on that?

Elsie Addo Awadzi:

I totally agree that there's a lot of miscommunication and confusion around that. What we've done at the Bank of Ghana is to publish industry guidance. So, we have what we call the sustainable banking principles, all of these based on ESG principles, which are very clear in terms of what we believe banks should be doing. We believe it's central to risk management, and it's essential to culture and values, basically the idea that banks should be operating clearly aware of environmental risks in their own operations, and in terms of how they engage with the market. And then, when it comes to social norms, basically banks understanding and being more aware of inclusion, ensuring that they're being inclusive in the way in which they operate both internally and externally. The idea of governance is really that strong governance is required, effective governance is required to help banks remain sound and stable.

And so, we have published what this means, and we require banks to disclose to us and report to us on a quarterly basis how they're complying with these principles. We encourage them to also make these reports public so that their clients and the public, especially those that are listed on the stock exchange, understand the extent to which they're incorporating these principles and these values in their work, and in a standardized manner, so that it can compare across institutions. So, I agree with the need for more guidance. There's a lot of guidance out there, frankly though, but I think jurisdiction by jurisdiction, it might make sense to clarify what is meant by this.

Clive Briault:

Okay. Will, anything you wanted to add on ESG guidance?

William Burn:

We do have a climate risk guideline, but our approach to climate risk is to bring it back to our mandate, which is to think about the risks associated with climate change and think about how that could affect safety and soundness of the institutions that we supervise. So, that's the perspective we have when we look at climate risk, and there is a guideline that we have.

Clive Briault:

Okay, thank you, Will. A question in chat probably more specific to Elsie actually, which is I think basically asking do you see any differences in culture across different types of banks? So domestic banks, subsidiaries of foreign banks, and also state-owned banks.

Elsie Addo Awadzi:

I think this is something I mentioned. This is probably referring to an earlier point I made. Yes, and there's actually a more fundamental reason why, at least from my experience. We often talk about the backstopping with the boards, but I would challenge that view and say the backstops are the shareholders ultimately because what we've seen is that the shareholders have a big

role to play, right, in all of this. And we have seen that when shareholders themselves believe in good values and accountability and strong risk management, they themselves are aligned with the boards that they put in place because shareholders are the ones that appoint the board members, they hold the boards accountable, and so on and so forth.

What we find is that when you have, at least in our context, subsidiaries or foreign-owned banks, they tend to be strong when it comes to value systems and risk management and all of that because they're typically playing to global standards and group-wide risk management frameworks. Because your parent banks are subject to strong supervision from other parts of the world as well, those parent banks exert some positive influence on the subsidiaries, because they have to report to their home supervisors on a consolidated basis and et cetera.

> What we find is that when you have subsidiaries or foreign-owned banks, they tend to be strong when it comes to value systems and risk management and all of that because they're typically playing to global standards and group-wide risk management frameworks.
>
> **Elsie Addo Awadzi**
>
> Bank of Ghana

I make the joke about, when I used to work at the Senior Treasury at Barclays Bank, early in my career, I felt that we got more supervised by Barclays Bank PLC UK than we did by the banking regulators in Ghana because every so often, for example, we would have an audit team from the head office from London coming over to Barclays Ghana to check how we were conducting our treasury operations, and so the shareholders themselves have a big role to play.

When you have state-owned banks, there's a tendency that persons appointed to the boards may be more sympathetic to a government agenda and very likely might exert pressure on management to conduct business a certain way that may not ultimately inure to the benefit of depositors or to the system as a whole. So, these are tendencies and supervision can play a big role, yes, but I'm really talking about tendencies.

You find that in our jurisdiction, the banks that have been here longest, over a hundred years, are subsidiaries of foreign banks. And you find that every so often, indigenous banks might fail because of pressures accepted by shareholders themselves. And so, we have taken a very serious view of how we keep our eye on who becomes a shareholder, a significant shareholder of a bank in Ghana because that's critical. And so that's really what I meant about seeing different cultures and value systems across the various segments of banks. Thanks.

Clive Briault:

Okay, thank you very much for that, Elsie.

Well, perhaps at that point, we'll move on to the second half of this webinar and focus on business model sustainability. Just before I do so, there was one request in the chat about sharing slides and I guess that means the notes of the speakers. There will be a transcript of the

webinar available, and that'll be available on the Toronto Centre website I think in a week or two's time. So, if you are interested in seeing the precise text of what's been said, there will be that resource available to you.

We move on next to business model sustainability. I think it's fair to say that most supervisory authorities are only just starting their work on this. So, what I want to do is ask Elsie and then Will to describe what they are developing in this area, how they intend to incorporate business model sustainability analysis within their supervisory frameworks, and how they intend to engage with the boards and senior management of financial institutions on this topic.

A bank could be doing well today, but if its business model isn't right, it's really going to be set up for failure. And so why wait until it actually fails, and begin to have conversations now?

Elsie Addo Awadzi

Bank of Ghana

Elsie, over to you first, please.

Elsie Addo Awadzi:

Thank you, Clive. Our current business risk-based supervisory framework already requires our supervisors to be mindful of the business models that banks operate, right? It's based on the size of the bank, the locations, the regional spread or the geographical spread, the complexity of its operations, etc. to be able to assess business model viability. So, much of this was really on paper and in theory only, and we expected supervisors to do what they could. But in the last year or so, we have begun to develop a framework, a more operational framework, that provides clearer guidance to our supervisors and to the industry, as well, as to how far we'll be going and what types of matters or areas will be avert in our minds too. It is still a draft, still a work in progress, and so we haven't started rolling it out, but we just felt that we needed a bit more personal meat around it so that there's more streamlined assessments of these.

Underlying all of this is the fact that a bank could be doing well today, but if its business model isn't right, it's really going to be set up for failure. And so why wait until it actually fails, and begin to have conversations now?

So, part of what we'll be looking at under this new framework would have to do with basically how the banks are set up in terms of how they generate their revenues, which sectors of the economy they're most exposed to and systematically so, how they deploy technology, for example, the extent to which they're deploying technology to advance their operations, and in that context, what kinds of vulnerabilities emerge just by virtue of the excessive reliance on that. What kinds of partnerships the banks are entered into within the operations, and basically having a clear view of what risks those pose as well.

So, this is early in that, but we expect that our supervisors are trained to be able to have these conversations, understand more strategically how these business models are evolving, how they contribute to risk or otherwise, and basically how they can be reviewed and repositioned so that banks are better able to survive going forward.

What we're doing as well is thinking through if a supervisor arrives at judgment that a bank's business model is high risk, what then does that leave us with? What tools do we have in place? What can we do about it? Do we have the power as supervisors to say, "Well, you've got to change your business model" and the bank says, "Well, the business model is ultimately a decision of the board and shareholders"? So, why does the supervisor tell us to change our business model and what risks is the supervisor themselves prepared to take along with this?

> If an institution doesn't address business model problems, that can lead to a loss of confidence which then results in financial stress. So, we want to equip supervisors to be able to identify business model issues and then respond appropriately by taking early corrective action.
>
> **William Burn**
> Office of the Superintendent of Financial Institutions

So, do we say change your business model and how so? Do we predetermine what business model then you need to do or do we just say these are excessive risks, you need to watch them and tell us how you intend to mitigate these risks? Do we use capital framework to require the bank to provide additional capital buffers relative to the excessive risks that we see? Do we have the power to say, "We think your business model is consistently so weak and so poor, that we actually have doubts about the quality of your governance, and so we want to remove or we're going to remove board members. We're going to ask you to change your key management personnel and all of that"? So, these are all very early conversations we're having here, and we look forward to framing things up in the not-so-distant future. Thank you.

Clive Briault:

Well thank you very much indeed for that, Elsie, and giving us a flavor of where you are in terms of making progress on business model sustainability. Will, what about OSFI?

William Burn:

Yeah, it was very interesting, Elsie, listening to you talk about it because I think we have a similar perspective on the importance of business risk and some of the complications associated with supervising. It's a really interesting topic. And I think while some elements are new, analyzing strategic and tactical business plans are time honored part of supervision, and it gained momentum after the global financial crisis as part of the impetus to follow the money and to put supervisors in a better position to talk about revenues and related risks in the context of an institution's strategy, capital liquidity and governance.

So, as Elsie was saying, I think business risk is an important early indicator of increasing credential risk because if an institution doesn't address business model problems, that can lead to a loss of confidence which then results in financial stress. So, we want to equip supervisors to be able to identify business model issues and then respond appropriately by taking early corrective action. But in doing that, we're not looking for supervisors to become business

analysts, but rather just to know the business, see the forest for the tree, so to speak, particularly around risk concentrations and dependencies, to understand the reliability of earnings as a risk manager, and also gain insights into risk governance effectiveness.

The topic's been an area of focus for us with the development of our new supervisory framework that I mentioned in the last segment. And with the new framework, we communicate our rating of business risks to the larger financial institutions along with our overall risk rating and the rating of three other topics, financial resilience, operational resilience and risk governance. The ratings help us communicate the outcomes that we're looking for institutions to achieve. So, for business risk, what we see that as is the risk of viability relating to an institution's business model, thinking about its strategy, risk appetite, and its ability to execute its plan. We're also careful to emphasize that the board of directors is responsible for the business plan and strategy, so we don't want to cross the line and issue recommendations that direct an institution strategy.

Very similar to what Elsie was talking about; if there was a concern about a concentration, our focus would be on the risk implications of that concentration. So, for example, are we satisfied with financial resilience when we look at the exposures, stressed in scenarios that are relevant to the macroeconomic backdrop? Has the institution got the right level of risk governance to manage those concentrations? So, we could be looking at outcomes that are relating, for example, to capital or risk-based limits relating to concentrations.

As we've seen from the revised Core Principles, this is a topic that's of high interest internationally, but there's not as much guidance on business model risk compared to traditional categories like capital liquidity or governance. OSFI's participating actively in work that's being led by the Basel Supervisory Cooperation Group to help develop assessment practices that supervisors can use to evaluate and respond to business risk.

So, while we're still in the early days of using our new supervisory framework, we are finding that the additional focus on business model sustainability is helping us engage with institutions and highlight the outcomes that address credential risks. Back to you, Clive.

Clive Briault:

Okay, thank you very much for that, Will, and thank you particularly there for mentioning at the end the further work being undertaken by the Basel Committee with a view to providing additional guidance. I'm sure that will prove to be extremely valuable for many supervisory authorities.

There was a question, Will, from Nancy in Ghana, which I think was asked at the end of the previous part, but I think it relates to both risk management and the assessment of sustainability. It was basically about how you would view the development of FinTechs offering financial services and products, and in particular, how they interact with and have an impact on the traditional banks. And perhaps in the context of the analysis of business model sustainability, that question becomes, how you would think about the potential competitive threats to the incumbent banks from new entrants? As a lot of countries have seen in recent years, there have been a lot of new entrants making use of financial technology in one way or another, and in some cases, beginning to eat away at some previously profitable banking

activities. So, Will, do you want to comment on that specifically as part of your analysis of business risk?

William Burn:

Yes. We see the impacts in a couple of different places. Often, FinTechs are third parties providing services to a regulated institution. So, we have a framework to assess third-party risk, and the starting point is that the regulated institution remains accountable for the services that they've outsourced, and we expect them to excise the right level of oversight and have access to the information for them to do that. And as you say, Clive, there's an also business model impact on regulated institutions as they compete with FinTechs, both within the regulated system and outside of it. So, that was one of our objectives with developing the business model rating was to assess the impact of disruption. And also, over time, to accommodate regulated institutions with non-traditional business models and help us to assess risks related to those business models as part of our supervisory framework.

Equally important is for supervisors and banks themselves to understand the implications of outsourcing, in particular cloud-based banking services, which is now the norm, and the role of third-party and fourth-party providers and how all of these relate to operational risk.

Elsie Addo Awadzi

Bank of Ghana

Clive Briault:

Okay, thank you for that, Will. Elsie, anything else you wanted to add to this question about the impact of FinTech and other emerging infrastructure?

Elsie Addo Awadzi:

Yes, definitely. So, just to add to what Will has said, it's really important for supervisors of banks to understand what additional risks these collaborations and partnerships bring about. I think I mentioned it in one of my earliest submissions. These third parties are playing a very important role in getting the banks themselves to become more cost-effective in their operations and to do business that they earlier on may not have been able to do or if at all at very high cost. In our parts of the world, they are also helping to reach the last mile of the population, and so it's incredibly important, but it's also important for banks to understand what these mean and the supervisors to understand as well.

Equally important is for supervisors and banks themselves to understand the implications of outsourcing, in particular cloud-based banking services, which is now the norm, and the role of third-party and fourth-party providers and how all of these relate to operational risk. Supervisors must understand risk across the value chain; it’s actually more complicated for bank supervisors now because they're not only dealing with banks with direct risks, but they're dealing with the additional risks are these arrangements bringing up from a third-party or fourth-party standpoint, what exactly are these doing, and how do we mitigate these risks and at what level? At the level

of the banks, at the level of the FinTechs, or at the level of cloud providers and other tech providers? So, it's become a little bit more complex for bank supervisors, and I think that there needs to be continuous work understanding that ultimately comes down to safety and soundness of the banks and of the safety of depositors' funds and we need to keep our eye on that. Thanks.

Clive Briault:

Okay, thank you for that, Elsie. Another question that was asked about liquidity risk and the challenges facing supervisors there. And perhaps, again, we could turn that into a question which also focuses on the sustainability of business models. Because you both mentioned the importance of looking at revenues and earnings, following the money, but given the recent examples of Silicon Valley Bank (SVB) and Credit Suisse, which both failed, among other reasons, because of a lack of liquidity and just losing a lot of deposits in a fairly short period of time. How would you see something like liquidity being factored into business model analysis? Elsie, do you want to go first on that one?

Elsie Addo Awadzi:

I would say that the business model of a bank would have implications for its liquidity and how it manages that liquidity. So basically, bank boards and senior management ought to understand the implications that a particular business model would have in the particular environment which it operates in. I'll give you an example. In Ghana, we saw that a lot of the banks were getting very exposed to the sovereign both in terms of the debt market on the bond market, the government bond market, as well as lending to private sector borrowers that were government contractors. That fast became a business model because these contractors get very fat and juicy contracts, they need banks to fund implementation of these contracts, and then they would pay. Now, it takes a supervisor who understands this to say, "Well, half of your assets are in government bonds, right? You've got maybe half of your loan book in contractor loans."

If you have any problem with the government's fiscal position, you're going to have a double whammy. You're bearing the risk of the government having to default on its bonds or restructure its bonds and you take a hit for it, and the government may not be able to pay government contractors soon enough, and then it means that they might not be able to service their loans.

So, what are the potential liquidity implications of this, what additional provisions are you making, and what liquidity management backup plans do you have in place should any of these risks materialize? So, that's just one example, and there are many other examples of business models and implications for liquidity. This is exactly the type of conversations that we expect supervisors to have with banks.

Clive Briault:

Okay, thank you very much for that, Elsie. Will, anything you wanted to add on liquidity business risk?

William Burn:

I agree about the strong linkages between the two, and I would also highlight, when you look at some of the examples you mentioned and you follow the facts back, the underlying issue is often a business risk one. So, with SVB, the rapid growth without the right level of risk governance supporting that growth led to issues that then eventually became a liquidity crisis. But had there been a corrective action in response to the business risk, that could've avoided the crisis.

Clive Briault:

Okay, thank you for that, Will.

> With Silicon Valley Bank, the rapid growth without the right level of risk governance supporting that growth led to issues that then eventually became a liquidity crisis. But had there been a corrective action in response to the business risk, that could've avoided the crisis.
>
> **William Burn**
> Office of the Superintendent of Financial Institutions

An interesting question in chat from Jerry, asking whether you would expect supervisors to be assessing the ability of the senior management of the bank to adjust their business model in the light of external shifts in the environment in which they operate. It almost takes us back, I think, to some of the things that were being discussed when we were talking about, culture, values, and behaviors. I could start with you, Will, on this. Is this an aspect of individual behavior of senior managers that you've considered?

William Burn:

This highlights the linkage between business model risk and risk governance and that you're looking for an institution to have the right governance in place to oversee its strategy and execution and when it encounters issues that it has the ability to respond to those appropriately.

Clive Briault:

Okay, thank you. Elsie?

Elsie Addo Awadzi:

Yes, exactly. We expect the boards to be able to do that, and really, there's no good strategy without scenario planning and scenario analysis, and there's no good risk management without understanding how you shift from one strategy or the other depending on your environment. In some of the environments that we operate in, small, open economies where the macroenvironment is particularly fast-moving and evolving, depending on external shocks, it makes bank strategy very susceptible to environmental change. We do expect bank boards to be very nimble in terms of how they think of strategy, in terms of how they think of evolving risks.

If you have a scenario where in one quarter you have a currency depreciation, which is very sudden and very high, you have inflation moving very quickly, and you have interest rates

moving very quickly, you almost always have to go back to your strategy to see what you need to do differently and what additional risks are going to play out because your borrowers, for example, may completely struggle to keep up with your loans. And sometimes there's a lock-in effect of this. So, you may not be seeing that immediately, but a good board will then begin to think of the future and see how best do we position the portfolio and what additional provisions to make. Thanks.

Clive Briault:

Okay, thank you for that, Elsie. Another question in the Q&A box from an anonymous participant, but I think it comes back to something you were talking about earlier, Elsie, in the sense that you've both mentioned the need for supervisors to approach business risk, business model sustainability in a very open-ended way and to take account of a wide range of factors given that one thing we know abouts supervisory authorities everywhere is that they face limited scarce resources. What can you do to develop the capabilities that will be necessary to undertake good business model sustainability analysis as this subject develops further? Elsie, something you mentioned earlier. So, do you want to pick up on it first please?

We are also finding that structured training programs for supervisors, such as the one offered by the Toronto Centre, the Certified Financial Supervisor program, is doing a good job of not only giving supervisors technical skills, but it's doing a good job of helping supervisors to make judgment and to grow in their own personal leadership skills.

Elsie Addo Awadzi

Bank of Ghana

Elsie Addo Awadzi:

Yes. So, a couple of things. In addition to making sure that bank boards themselves understand the risk implications of what they do, what banks contribute to the entire banking system, and therefore how they must be careful. Bank supervisors need to be trained, they need to acquire skills such as basic financial analysis skills, but more and more strong corporate governance awareness and training. Strategy and risk management capabilities will be necessary, the role of technology in finance and how that's disrupting banking business models, and the risks attached to that and how those risks must be managed. But what we find is that having a unit within the supervisory team or a group in the supervisory team that is thinking of emerging risks, thinking of banking risks, and how these risks need to be managed. These are usually multi-skilled, multidisciplinary teams. Usually what you don't always find in supervisory teams, but you need to bring them together so that they're constantly thinking of risks and how to model risk and how to feed that into all the work that supervision does.

We are also finding that structured training programs for supervisors, such as the one offered by the Toronto Centre, the Certified Financial Supervisor program, is doing a good job of not only giving supervisors technical skills, but it's doing a good job of helping supervisors to make judgment and to grow in their own personal leadership skills. That allows them to go sit with a

bank CEO and have conversations about strategy in a way that the bank CEO is receptive to, and a bank that the supervisor is also able to manage carefully. And so, increasingly, those are very important skill sets to acquire for supervisors, and we want to thank the Toronto Centre for making that available to our supervisors. Thanks.

Clive Briault:

Okay, thank you for your kind words for the Toronto Centre there, Elsie, but even more so thank you for your comments on the more general approach to building those capabilities of supervisors. Will, anything you want to add to that?

William Burn:

Elsie said it really well, and I would agree about the importance of having pro-risk and emerging risk monitoring and also working to build capabilities of supervisors. At OSFI, we're very focused on enabling supervisors with the right skills and technology and data to help them do a really good job. We've grouped those altogether within one team. It's called the Supervision Institute, but it's all part of that focus about helping supervisors do a good job in a rapidly changing risk environment.

Clive Briault:

Okay, thank you very much for that, Will.

Well, we've come to the end of the hour allotted for this webinar and I don't want to exceed the time slot available. So, perhaps I could just close by saying, first of all, thank you very much to Elsie and Will for their very perceptive comments and their willingness to answer as many questions as we're able to get through. Thank you also to the translators for providing the proceedings in French and Spanish, for those wishing for that. Thank you also, of course, to you, the participants in the seminar for signing in and coming along and for the excellent questions that you've been asking. Thank you for all of that, and I can only apologize if we didn't have time to answer all of your questions, but I think we managed to answer most of them.

Finally, thank you also to Toronto Centre for organizing the webinar. As I said, this was the third one in a series on the new revised Basel Core Principles, and I think there may be a couple more in the pipeline, so keep an eye out for that. As I said earlier, if you have missed the previous two webinars, I think they are available both as recordings and transcripts on the Toronto Centre website. So, if you're interested in pursuing that, please do so. Thank you all very much. I hope I haven't missed anyone to thank, and at that point, the webinar is duly closed. Thank you very much.