Deutsche Bank

31 January 2014

Deutsche Bank AG
Winchester House
1 Great Winchester Street
London EC2N 2DB

Tel: +44 20 7545 8000

Direct Tel +44 20 7545 1903
Direct Fax +44 20 7547 4179

Secretariat to the Financial Stability Board
Bank for International Settlements
Centralbahnplatz 2
CH-4002 Basel
Switzerland

fsb@bis.org

Dear Sir / Madam,

Deutsche Bank response to Financial Stability Board (FSB) consultation on Guidance on Supervisory Interaction with Financial Institutions on Risk Culture

Deutsche Bank (DB) welcomes the opportunity to respond to the consultation on *Guidance on Supervisory Interaction with Financial Institutions on Risk Culture*. Overall, we found the structure and content of the draft guidance to be very appropriate and we believe that this will result in an effective tool to support supervisors in their on-going assessment of risk culture within the financial service industry. In particular, we believe it is effective in outlining all the relevant key concepts - including the IIF definition of risk culture - for consideration in a principles-based way, to allow for interpretation as appropriate to a particular institution.

Our responses to the consultation questions and suggestions in the Annex therefore focus on areas where the drafting might be further enhanced to provide clarity for firms and supervisors alike when considering the design, implementation and assessment of risk culture frameworks. Our comments focus on the following areas:

- Acknowledgement that there are many methods for assessing a risk culture and providing firms and supervisors flexibility to apply these as appropriate;
- Enhancing the principles-based approach to address points where the guidance risks advocating a "tick box" approach to track risk culture information;
- Ensuring that the guidance is a tool to drive continuous improvement on risk culture and enhanced dialogue between supervisors, boards and senior management; and
- Clarifying the role of the Board and the distinction between their responsibility to set the risk culture framework and that of senior management to embed and deliver it.

With a few clarifications we believe that this Guidance will be an effective support tool for supervisors and the financial services industry, particularly to establish a common understanding of the key drivers of risk culture and potential mechanisms to assess it. We trust you find our comments helpful and are happy to discuss further any part of our response.

Yours sincerely,

Andrew Procter
Global Head of Compliance, Government and
Regulatory Affairs

DB responses to questions for public consultation

General questions

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

   We believe that the main areas have been considered. Some sections, however, could provide further clarity or flexibility, and we have provided specific drafting suggestions in the Annex.

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

   Yes. There are some areas where clarity or minor change would be useful. For example, the Guidance should distinguish between the respective roles of the board and senior management. The Annex provides specific drafting suggestions.

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

   Yes. While it should be up to individual institutions to determine their own risk culture and broader corporate culture, we agree it would be useful to use definitions to clarify the distinction between the two. This should articulate clearly that risk culture must be a component of any broader corporate culture within the financial services industry. It should also be explicitly recognised that sub-cultures may exist, but that this is acceptable if they are aligned with the overall high level values and pillars which support a sound risk culture.

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

   We suggest that the final guidance should distinguish between tools used i) to develop and sustain an appropriate risk culture and ii) to evaluate risk culture. It is also worth noting that such tools may be ad-hoc or on-going where appropriate. All the tools listed here may be helpful, but it is important that the final guidance is clear that no suite of tools should be considered as a checklist for either management or supervisors. Supervisory assessments should instead review the holistic approach of an organisation to driving improvement. Behavioural change across an organisation can rarely be effected by a single process. One additional tool to reference and to be encouraged where appropriate, is assessment of root causes of failures, to promote a two-way dialogue with senior management on the resulting observations.

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

   We expect risk culture to be part of an open dialogue. The final guidance should stress that supervisors' observations should be shared with the board and senior management in order to promote such a dialogue and develop shared understanding. Where it is appropriate for these observations to result in regulatory findings, these should focus on clear operational outcomes to enhance specific elements of risk culture rather than general objectives to "improve culture". Failure to mitigate such findings would then be subject to the existing suite of enforcement options.

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

   To foster the constructive dialogue outlined above, the guidance should encourage supervisors to ensure that their staff have sufficient seniority and experience to engage effectively with senior management, in order to better understand and challenge an organisation's tools to enhance and evaluate its risk culture.

Indicators of a sound risk culture

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

Yes, but please see the Annex for specific drafting suggestions to enhance them.

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

We believe that culture cannot be improved through any single initiative requires a dedicated focus over time. In an effort to drive continual improvement, there is value in a programme solely focused on improving risk culture. Such a program might include components such as: communication (tone from the top); training; accountability; and monitoring. Such a programme benefits from senior cross-divisional and cross-functional sponsorship. Dedicated focus and cross-divisional partnership have been critical to the success of many of its initiatives. One successful example is the "Red Flags" process, which explicitly links individuals' adherence to an expected set of risk culture behaviours to their performance assessment and to compensation and promotion decisions. Other disciplinary action may also be taken, depending on the severity or frequency of incidents, up to and including dismissal. These expected risk culture behaviours link to our overarching corporate Values and Beliefs, which have recently been refreshed and which are being embedded across the organisation in a granular way through numerous workshops at all levels to ensure that there is buy-in to these new expectations.

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

The indicators are broadly aligned with our approach to risk culture. We agree the right indicators are included but have outlined specific drafting suggestions in the Annex.

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

In our view, the paper does not adequately distinguish the roles of the board vs. senior management. The board should ensure that an appropriate framework exists to promote a strong risk culture. Senior management is responsible for the operation of this framework. We believe this distinction is important. However, the board should be directly responsible for setting the appropriate tone and taking action when issues are escalated. We have provided specific comments with respect to these respective roles in the Annex.

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

We believe there are many mechanisms that support the development of a sound risk culture including (but not limited to) the compensation framework, the performance assessment process, and the risk appetite and risk management frameworks. As stated in our answer to question 8, there is value in a dedicated programme to oversee initiatives aimed at enhancing risk culture. This programme has driven enhancements in several areas but should not be viewed as the only mechanism to enhance overall risk culture.

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

We agree it is important for institutions to set clear expectations for behaviour in a tangible way, but this is best managed by each individual institution. For example, an organisation should define expected risk culture behaviours and communicated them through multiple communication channels as well as dedicated training. They are used to define the behavioural norms we expect from our employees with respect to risk culture.

Annex: Specific Drafting Suggestions

1. **Foundational elements of a sound risk culture** - the three pillars highlight the right core elements but the section on compensation should note that compensation amounts and structures (i.e. cash vs. deferrals) should not only reflect risk-taking but also an individuals' overall behaviour as it aligns to the organisation's expectations, including risk culture. We also suggest changing "determinant" to "element" under *Risk Appetite*, as the relationship between the two is not always this simple. For example, a risk culture failure may not always mean that the defined risk appetite has not been achieved.

2. **Indicators of a sound risk culture** - we agree these are the right four areas on which to focus but suggest the following edits to these points:

   - *"Tone from the top"* should distinguish between i) whether there is leadership in terms of communication, setting expectations and modelling behaviours and ii) whether the board and senior management have ensured that processes are in place to deliver the risk culture framework and to assess its effectiveness.
   - *"Accountability"* and *"Effective challenge"* both risk appearing as more like goals than indicators. Both should focus on an institution's responsibility to put mechanisms in place to ensure i) employees are aware and accountable for risk culture and ii) to facilitate effective challenge (e.g. through performance assessments that encourage it).
   - *"Incentives"* references "risk management" behaviour - to be consistent this should be "risk culture".

3. **General and Supervisory Guidance**

The current references to an institution's *"willingness to sufficiently document"* risk culture could encourage a rigid, audit-based approach. This may lead to a "tick box" mentality rather than a holistic approach by the institution to ensure an effective risk culture is in place. This also may inhibit an open dialogue with the supervisor. Instead, we suggest the final guidance should say ***"The supervisor should assess the extent to which the institution is able to define its risk culture, document the material elements that support it and actively assess gaps or areas of concern to be addressed or enhanced".***

Leading by example:

3.1.3 We suggest adapting this to: *"The board and senior management promote through actions and words, a risk culture that expects integrity and a sound* ***approach to the management of risk, which promotes an open exchange of views, challenge and debate****".* This would better reflect the behaviours required to promote a strong risk culture.

3.1.4 To clarify the respective roles and obligations, this point should therefore read: *"The board and senior management* ***have ensured that effective mechanisms are in place so that directors and all employees can carry out their roles in line with the defined risk culture, including mechanisms to promote effective challenge throughout the organisation****".*

3.1.5 The concept of "*dominant personalities*" is very subjective and can vary across cultures. In any case, risk culture should focus on behaviours. For example, the EU CRD IV focuses on ensuring dominant behaviour does not negatively affect the wider institution - we therefore suggest: "*The board and senior management have mechanisms in place, such as talent development and succession planning,* ***to ensure that decision-making is not dominated by any one individual or small group of individuals in a manner that is detrimental to the interests of the institution as a whole."***

Assessing espoused values:

3.1.6 This point is very similar to points 3.1.3 and 3.1.5. and - as set out below in feedback to point 3.1.7 - we do not believe that the board should be responsible for granular assessments but rather for ensuring the appropriate framework. This could be addressed by amending to: *"The board and senior management* ***have mechanisms in place to ensure that the espoused values are communicated to management and staff at all levels so*** *that the "tone from the middle" and throughout the institution is the same as the "tone from the top."*

3.1.7 The current text suggests that the board would be responsible for conducting a very granular assessment of this point. This could be addressed by adjusting to read: *"The board and senior management* ***ensure the financial institution's risk appetite is clearly defined, is aligned with business strategy and is supported by an appropriate risk management framework. They should ensure appropriate mechanisms are in place to assess that these are effectively embedded, understood and adhered to by employees at all levels****".*

3.1.8 For clarity, we suggest moving this point to the "Incentives" section as it aligns directly with remuneration. In addition, we suggest adjusting to emphasise more than just risk-taking behaviour by saying: *"The board and senior management have established a compensation structure that supports the institution's espoused core values and promotes* ***a sound risk culture****".*

Ensuring common understanding and awareness of risk:

3.1.9 This seems to imply that the board ought to assess decisions made throughout the business. It should align with FSB risk appetite principles and make clear that they should ensure that the organisation has the tools and mechanisms at the appropriate level to make the right decisions. We therefore recommend the following revision: *"The board and senior management have* ***appropriate decision-making mechanisms in place to ensure the risk appetite, risk management strategy, and business strategy are effectively aligned and embedded in decision making and operations at all appropriate levels of the organisation****".*

Learning from risk culture failures:

3.1.13 We recommend deleting this point as it appears to duplicate 3.1.12.

Escalation process:

3.2.3 This should clarify the institution's responsibility to define consequences for non-adherence: *"Employees are held accountable for their actions and behaviours* ***and understand the consequences if they are not aligned with the institution's core values, its risk appetite and the support of a robust risk culture. This is*** *regardless of whether their* ***actions or behaviours*** *resulted in* **direct** *financial gain or loss to the financial institution".*

3.2.4 This point currently mixes up risk mitigation and whistle-blowing (covered in 3.2.6) while "use" of processes is covered in point 3.2.5. We suggest rewording to: *"**Appropriate** escalation processes are established* ***to support the risk management framework and*** *clear consequences of non-compliance with escalation procedures* ***are defined****".*

3.2.5 We recommend deleting "and dissent" as "critical challenge" better reflects the intent of the Guidance to seek to encourage alternative views. We also suggest changing the title of the following section to "Open to effective challenge" (i.e. section 3.3).

Open to dissent:

3.3.2 Assessments of *"all layers of management"* suggest tracking of all contributions to all decisions or meetings and, as above, "challenge" is a better word than "dissent". Instead, we suggest ***"requests regular assessments of the openness to challenge at all layers of governance and how it is embedded within the performance assessment process****."*

Remuneration and performance:

3.4.2 To prevent this from becoming a "tick-box exercise", we recommend altering the wording to say, "*Annual performance reviews and objectives-setting processes* ***are linked to the*** *financial institution's desired core values* ***and behaviours and*** *compliance with policies and procedures****, including points addressing*** *internal audit results and supervisory findings* ***as appropriate****"*.