## Using the Structural Equation Model to Explain the Effect of Supervisory Practices on Regulatory Density

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Abstract : In the economic system, the financial sector plays a crucial role as an intermediary between market participants, other financial institutions, and customers. Financial institutions such as banks have to make decisions to satisfy the demands of all the participants by keeping abreast of regulatory change. In recent years, progress has been made regarding frameworks, development of rules, standards, and processes to manage risks in the banking sector. The increasing focus of regulators and policymakers placed on risk management, corporate governance, and the organization's culture is of special interest as it requires a well-resourced risk controlling function, compliance function, and internal audit function. In the past years, the relevance of these functions that make up the so-called Three Lines of Defense has moved from the backroom to the boardroom. The approach of the model can vary based on the various organizational characteristics. Due to the intense regulatory requirements, organizations operating in the financial sector have more mature models. In less regulated industries there is more cloudiness about what tasks are allocated where. All parties strive to achieve their objectives through the effective management of risks and serve the identical stakeholders. Today, the Three Lines of Defense model is used throughout the world. The research looks at trends and emerging issues in the professions of the Three Lines of Defense within the banking sector. The answers are believed to helping to explain the increasing regulatory requirements for the banking sector. While the number of supervisory practices increases the risk management requirements intensify and demand more regulatory compliance at the same time. The Structural Equation Modeling (SEM) is applied by making use of conducted surveys in the research field. It aims to describe (i) the theoretical model regarding the applicable linearity relationships, (ii) the causal relationship between multiple predictors (exogenous) and multiple dependent variables (endogenous), (iii) taking into consideration the unobservable variables and (iv) the measurement errors. The surveys conducted on the research field suggest that the observable variables are caused by various latent variables. The SEM consists of the 1) measurement model and the 2) structural model. There is a detectable correlation regarding the cause-effect relationship among the performed supervisory practices and the increasing scope of regulation. Supervisory practices reinforce the regulatory density. In the past, controls were placed after supervisory practices were conducted or incidents occurred. In further research, it is of interest to examine, whether risk management is proactive, reactive to incidents and supervisory practices or can be both at the same time.

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