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Strengthening Financial Risk Governance and Compliance in the U.S.: A Roadmap for Ensuring Economic Stability

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Abstract:- While US lawmakers consider loosening financial regulations, this article addresses the need for stronger financial risk governance frameworks to ensure regulatory compliance and mitigate systemic risks in the U.S. financial system. It provides a road map for financial institutions and policymakers to enhance risk management processes and avoid failures in a volatile economic environment. The only significant advancements in the monitoring and regulation of the financial sector in the United States have come from financial catastrophes. Achieving sustained growth and low inflation is contingent upon the financial system's stability, demonstrated by well-functioning financial institutions operating without significant difficulties. Due to the global financial crisis, banks' corporate governance procedures have been reexamined. Some policymakers are wondering how much managerial entrenchment and the board's failure to keep an eye on executives may have contributed to excessive risk-taking and financial instability. The implementation of favorable policies has been critically examined to ensure the suitable delivery of a stable in the United States.

Keywords:- *Risk Governance; Regulatory Compliance; Systemic Risk; Financial Stability; Policy Development.*

Acronyms

Abbreviation	Meaning
RegTech	Regulatory Technology
U.S.	United States
FIH	Financial Instability Hypothesis
IMF	International Monetary Fund
WB	World Bank
WTO	World Trade Organization
PPP	Public-Private Partnership
FSB	Financial Stability
FCPA	Foreign Corrupt Practices Act
EU	European Union

I. INTRODUCTION

The rules, procedures, and processes that assist in identifying the risk or risks and implementing appropriate corrective measures are referred to as risk governance. It helps management implement suitable risk-reduction techniques (Nhar et al., 2016). This body of knowledge offers a strong theoretical foundation, empirical support, and a compelling argument that many risks cannot be evaluated solely based on probability and effects and that regulatory models based on that assumption are not only insufficient but get in the way of managing risk responsibly (Van et al., 2011).

Economic units incur financial risk when they bind themselves with loans and pledge to pay them back, or when they obligate themselves to finance an asset position. The two financial risks include; default risk and liquidity risk. In default risk, the borrowers are not usually able to repay, while liquidity risk occurs when economic units are forced to borrow at very high rates (Dymski et al., 2008). In their review work on risk governance, Gontarek et al. (2018) explained that the number of bank failures in the United States increased to 387 during the three years that ended in 2011, from 28 during the three years that preceded it. Including government borrowing to pay for bailouts, with the total amount of debt in the world which has grown by $70 trillion since the financial crisis in the United States rose to $237 trillion.

For top executives and regulators, assessing the risk frameworks and cultures of large financial institutions is a significant task. Although evaluating based on organizational results is one method, successful risk management produces long-term sustainability and improved risk-adjusted performance that is seen over decades (Sheedy & Griffin 2018). According to Lingel & Sheedy (2012), there is evidence in the US context to bolster the risk governance hypothesis, which holds that risk outcomes can be predicted by risk governance mechanisms based on public data.

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A simple example of a traditional risk management process would be a small group of people in the finance department hedging currency risk or a factory floor manager keeping track of work-related injury incidents. Traditional risk management involves identifying risk, measuring risk, monitoring, and possibly reporting risk, but with little formality, structure, or centrality (Lundqvist 2015). According to Pirson et al. (2011), there was a significant concentration of the US subprime and prime mortgage market, with 25 companies controlling 90% of the whole market. With a single board, the 25 businesses functioned as hierarchies under central control.

II. IMPROVING REGULATORY COMPLIANCE TO ENSURE ECONOMIC STABILITY

Adherence to laws, rules, and regulations pertinent to a firm is known as **regulatory compliance**. In the financial industry, regulatory compliance guarantees the honesty and openness of financial institutions, protecting stakeholders' interests and preserving the financial system's stability (Bibitayo et al., 2024). It is important to consider how regulatory modernization relates to and differs from the frequently mentioned "financial modernization." Legislation that eliminates earlier structural limitations on financial intermediaries symbolizes financial modernization. Legislators have given the financial modernization movement a lot of attention, especially in the US (Schooner et al., 2003).

The United States invests a lot of money, particularly at the federal level on gathering data on the advantages and disadvantages of regulation. However, it is by no means the only nation eager to create regulations that are more effective and efficient (Hahn & Litan 2005). The global financial crisis has led to changes in banking regulation and supervision, but their implementation will depend on national policies in each country. These changes may or may not have an impact on bank risk-taking depending on the institutional and financial environment in which the banks operate (Ben Bouheni F., 2014).

Strong socioeconomic interests and values have always existed, allowing economic actors to act any way they choose until the money breaks. These same forces have occasionally blocked the necessary changes that would have improved regulation and oversight in the United States (Tymoigne, 2009). Nevertheless, the Federal Reserve Bank of New York calculates that the aggregate risk-weighted common equity ratio of the largest US banks increased from approximately 7 % in the years before the financial crisis to approximately 13 % as of the end of 2017 (Tarullo 2019).

Following Das et al. (2003), it is possible to argue that the existence of a financial system that can effectively allocate funds to investment opportunities over an extended period without experiencing significant disruptions is the primary cause of financial stability. For the first time, financial markets started closely examining each nation's macroeconomic circumstances and pricing sovereign risk appropriately. This rapidly heightened the possibility of the US sovereign default and drove the price of sovereign borrowing to an almost unbearable level (Lupo 2013). The institutional realization that household decision-making. is becoming increasingly financialized and has shifted the focus of U.S. regulatory policy away from the traditional worries about bank stability (Bieri 2015).

The rapid and intricate advancements in technology typically require assistance from traditional regulatory frameworks built for conventional financial systems to stay up to date. Because of this mismatch, the regulatory landscape is fragmented, which puts consumer protection and financial stability at risk (Bibitayo et al., 2024). Even though the term financial stability is used often, it is surprisingly unclear what economic stability regulation aims to accomplish. Some people may believe that financial stability means the financial markets are stagnant and ossified; proponents of this theory may oppose financial stability regulations because they aim to stop all risk-taking within the financial system (Allen 2018).

The financial instability hypothesis (FIH) is based on the observation that capitalist economies occasionally undergo asset inflations and deflations, which can worsen the financial system as a whole. To put it simply, FIH maintains that financial system stability eventually leads to destabilization (Duff et al., 2018).

➢ *Challenges of Regulatory Compliance in the US Economy*

The U.S. President's Working Group on Financial Markets gave an overview of the causes of financial instability. The causes are; the collapse of market discipline by participants in the mortgage securitization process; defects in credit rating agencies' evaluations of subprime mortgages; inadequate risk management at major financial institutions; and a failure on the part of financial institutions to address these risk management deficiencies (Pan, 2010). To address these challenges, the concept of Regulatory Technology (RegTech) has emerged as a crucial element in modern financial systems. RegTech leverages advanced technologies to improve regulatory compliance processes, making them more efficient, accurate, and adaptive. By automating compliance tasks and enhancing data analytics capabilities, RegTech solutions can help financial institutions manage risks more effectively and ensure adherence to regulatory standards (Bibitayo et al., 2024).

The Gramm-Leach-Bliley Act of 1999 was passed by the United Kingdom and the United States. These laws address a few prevalent issues with financial regulation in the twenty-first century. They include broad globalization, tenacious rivalry, sophisticated industry consolidation, and ceaseless technical advancements (Schooner et al., 2003). However, the FSB has been assigned a key role in fostering global financial stability rather than serving as a band-aid solution to the crisis.

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According to U.S. Treasury Secretary Timothy Geithner, the IMF, WB, and WTO should have been the "Fourth Pillar" of global economic governance, and the FSB should have followed suit (Pagliari, 2012).

The FSB will bolster the institutional underpinnings of global regulatory cooperation if these obstacles and priorities are effectively addressed. Its primary function would still be to facilitate transgovernmental networks, with ultimate authority for financial regulation and supervision continuing to rest firmly at the national level, rather than developing into a potent international organization (Helleiner 2010). The risk-adjusted balance sheet is the fundamental analytical tool since it illustrates how vulnerable the company's assets and liabilities are to outside "shocks" (Gray et al., 2007).

The process of comprehending, estimating, and effectively controlling unexpected degrees of unpredictability in the financial consequences for business is known as risk management. Reducing risk to a manageable level at a reasonable cost involves the steps involved in choosing and putting mitigation measures into place. The word "acceptable" is crucial in this context. It needs to be defined using a risk-reward framework that takes into account the asset's worth as well as the potential long- and short-term losses (Paquette et al., 2010).

Financial stability allows for the unrestricted use of the organization's resources, reflects a consistent surplus of income over expenses, and supports the continuing process of product development and sales. As a result, the primary component of an organization's overall stability is its financial status, which is defined as the ability to balance an organization's financial resources and loans with its creditors, owners, and budget (Drobyazko et al., 2020). Conversely, financial instability has the potential to hinder economic activity and lower economic well-being. The pressures placed on households and businesses as a result of dysfunctional financial markets or key institutions could hurt the real economy by preventing capital from flowing to worthwhile investments and possibly leading to credit crunches (European Central Bank, 2007).

In the wake of the Great Financial Crisis, Risk management, detection, and mitigation of risk has taken center stage, particularly Systemic risk. The Federal Reserve, the European Banking Authority (EBA), and domestic and international regulatory supervisors have been leading the way in the design and implementation of stress tests to provide supervisory evaluations of capital adequacy and capital planning at systematically significant banks (SIBs) (Taskinsoy, 2020).

It is believed that generally speaking, banks face credit, operational, and liquidity risks. However, the types and degrees of risks to which an organization may be exposed depend upon several factors such as its size, complexity, volume, and business activities (Bunea et al., 2009). The central bank is frequently tasked with handling these risks on a national scale. However, these kinds of risks are difficult for central banks to analyze with the traditional models and analytical tools they currently employ (Gray et al., 2007). The degree of financial stability varies greatly over time and among nations. Since 1997, the asset portfolios of North American banks have seen a sharp increase in correlations and volatility. However, as banks' capitalization has grown over time, the systemic risk in the North American banking system has reduced (Lehar, 2005).

Furthermore, by transferring risk to more reliable financial organizations, innovations may improve the efficiency with which risks are distributed within the financial system. Because of the increased system liquidity throughout the risk transfer process, stability may also rise (Buston et al., 2013). The adoption of new technology or regulations will unavoidably cause creative destruction both inside and across enterprises when it comes to transition risk. While the rise and fall of products or enterprises is a standard aspect of the modern economy, transition risk is suggestive that the scope and rapidity of economic transformations could exceed the historical speed of change that the financial industry is accustomed to. Furthermore, adverse consequences may vary by region and industry, even if macroeconomically the rise in green sectors balances the fall in emissions-intensive sectors (Brunetti et al., 2022).

III. COMPLIANCE AND ETHICAL STANDARDS

Many in the United States see policies like the Foreign Corrupt Practices Act 4 as well-intentioned attempts to make US businesses adhere to impractical ethical standards that the rest of the world rejects. Equitable dealing appears to be a trap for the unsuspecting or the credulous, as much as commerce (Micheal et al., 1996). The private sector provides services that complement and enhance military capabilities, not replace them, and this is how the United States and many other nations rely on it. To meet these needs, the industry is in place. It is included to assist in making strategic decisions rather than to make them (Brooks et al., 2012).

The FCPA was enacted in reaction to revelations of several claims made in the 1970s that American companies had bribed foreign officials. The first revelation concerned the defense aerospace corporation Lockheed Corporation, which was shown to have bought politicians in numerous nations including Italy and Japan to favor their military aircraft in deeds that went back to the 1950s (Mensah & Chiang, 2019). Depending on the industry, organization location, and size of the company, different compliance standards may apply. Critical components of an effective compliance program include routinely conducting audits, gathering all required documentation for transactions, and ensuring all implemented internal policies and procedures are followed. Proper ongoing education and training for the company's leadership is crucial

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to creating a strong compliance program (Bezuidenhout, 2022).

While simple compliance programs stop illegal activity, complicated programs address issues like customer happiness, staff morale, and public image. The current trends of public commitment, business environmental and social responsibility, and ethical awareness are all ingrained in compliance management (Benedek, 2012). Enforcing effective corporate governance is crucial for financial institutions. It should consider all facets of this sort of business, where risk is a daily occurrence and accurate asset and liability assessment should be an ongoing activity. Since depositors make up a sizable portion of the banks' funding obligations, the credit institution should specify what its obligations are to them (Nicula, 2012).

The U.S. Sentencing Commission's 1991 Guidelines for Organizational defendants, which prescribed more lenient sentences and fines to companies that had taken steps to prevent employee misconduct, are largely responsible for the proliferation of legal compliance mechanisms that address ethics or conduct issues in formal documents, which many US companies have adopted (Arjoon, 2005). Coherence within a set of regulations that are both sufficiently bureaucratically developed to allow for their development, implementation, and enforcement, as well as comprehensive enough to offer closure, is necessary for self-regulatory autonomy (Cata Backer, 2011).

➢ *Global Coordination of US Financial Regulation*

Coordination of international policy is important to investors and financial firms since cross-border regulatory discrepancies can benefit them or hurt them. The expenses of foreign financial transactions are increased by even minor mismatches. Furthermore, regulatory disparities might further protectionist objectives by impending market access for outsiders and protect the territories of local competitors (School et al., 2008). Ahdieh et al. (2015) stated that beginning with a thorough understanding of the global endeavors of the U.S. Securities and Exchange Commission, particularly its goals of greater harmonization in securities law, Braunger contends that theories of “transgovernmentalism” fall short of addressing the complexity of contemporary global financial regulation.

There have historically been two primary justifications for harmonizing financial regulatory laws between nations. The first is the well-known issue of a regulatory "race to the bottom," which is the propensity of legislators to forego strict regulations to provide domestic banks a competitive edge over their counterparts in other jurisdictions. The second problem is "leakages," which are instances where banks can create subsidiaries in other countries with less stringent restrictions to get around local laws (Kharroubi 2021). State-of-the-art theories of global governance anticipate that financial regulation reform will be implemented globally with a relatively high degree of efficacy due to the global alignment of incentives in the wake of the crisis and this dual governance innovation (Knaack 2015).

Proposals for regulatory reform in the US, EU, and other major jurisdictions have focused on more rigorous oversight of financial institutions by regulatory supervisors, which calls for real-time information access, improved understanding of the global operations of financial institutions, and a wider use of discretion on the part of these supervisors (Pan 2010). A case study of how municipal dynamics can influence international relations, and American regulation of foreign financial institutions may provide insight into other nations' experiences during the 2008 financial crisis and the United States' during earlier ones (Kean et al., 2018).

The integrity of the entire financial and economic system depends on their financial stability, even though they use this business model to pursue profitability and value maximization. The integration of AI into national financial policy is not only strategically significant but also a critical step toward ensuring long-term economic stability in an increasingly unpredictable global environment. The use of AI for economic forecasting, risk management, and decision-making will continue to reshape the landscape of modern finance, providing a path forward for businesses, regulators, and policymakers (Jodian and Boris, 2024). Systemic hazards can arise from the banking system's interconnections with other financial sectors and the economy (Raouf 2017).

Better cooperation among regulators is therefore the cornerstone of this preparedness strategy, with the aim that it will result in enhanced trust and coordination during a future crisis. The emphasis on creating avenues for collaboration and information exchange explicitly addresses the shortcomings in coordination between US and UK regulators during the situation surrounding Lehman Brothers (Riles, 2014).

IV. RISK MANAGEMENT FOR POLICY DEVELOPMENT

Risk is defined as an event's potential influence or outcome on an organization's assets and the ensuing fallout. The balance between expected and unforeseen effects defines and categorizes risk, not the risk itself. "Value at risk" is the term used in economics to describe this statistical measure that determines the impact of a loss based on the likelihood of it happening (Paquette et al., 2010). The United States' initial attempts to include environmental services in laws and initiatives aimed at appreciating services that could be easily exchanged in a market as well as creating markets for such services (Schaefer et al., 2015).

Edge & Liang (2017) discovered that although there has been a sharp increase in central bank financial stability reports and risk communication since 1996, the results did not seem to be improving. Additionally, if members are currently using

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their current instruments to fulfill their other existing requirements, they might not be able to accomplish new financial stability goals. In comparison to two different tools for the two aims, Edge & Liang (2017) simulate welfare costs where monetary policy is the only means of achieving price stability and credit spread moderation.

Treasury management tends to be an important technique viable in managing risks in this world of increasing cyberattacks on financial institutions. To effectively counter this threat, financial institutions must implement a comprehensive risk management technique, among which is the Repo risk management technique (Boris and Jodian, 2024). Within a regulatory community that replaces the state and its organs with corporations, investors, consumers, nongovernmental organizations, and the media, the largest enterprises can now satisfy their regulatory preferences and impose their own rules due to the freedom of capital and operations (Cata Backer, 2011). For businesses operating in all industries, risk management is unquestionably essential to both short- and long-term financial performance since it allows for the reduction of losses from poor risks and the facilitation of gains from positive ones. Financial intermediaries are crucial to the economy and financial system because they transmit savers' money to businesses and families that need to borrow it, collecting deposits and supplying credit to the real economy (Raouf 2017).

The policy of counter-cyclicality is essential in overcoming pro-cyclical patterns of behaviors in economic and financial regulation, likewise, inappropriate financial regulation due to liberalization within and across countries should be thoroughly checked and corrected (Griffith-Jones & Ocampo 2011). Employing data from the United States, we discover that, in contrast to non-financial companies, there is a greater correlation between shareholder-friendly corporate governance and stand-alone and systemic risks for banks. This result is in line with the theory that banks, as opposed to non-financial companies, should be the primary recipients of a financial safety net (Anginer et al., 2018).

Although most businesses can function normally with the support of a framework for financial stability, some businesses may even benefit from the instability. Corporate governance is also subject to voluntary adoption, barring specific legislative limits (Lupu, 2015).

- *Incorporating Public-Private Partnership into Risk Governance*

A PPP is characterized as a contract between a private party and a public sector institution, wherein the private party assumes substantial financial, technical, and operational risk in the project's design, financing, construction, and operation (Nel 2013). PPPs can take many different forms, but the most popular kind is long-term contracts in which the private sector finances, constructs, and/or maintains the infrastructure while also taking on the risks related to its availability and/or demand. PPPs offer the comparative benefit of boosting design efficiency, raising service quality, and lowering overall project costs and delays because of the synergies between construction and maintenance. This is in addition to drawing in private capital (Prats 2019).

Towards a Framework for the Governance of Infrastructure, a paper released by the Organization for Economic Cooperation and Development (OECD) in 2015, encapsulated the sentiment of an advancement in economic stability through the incorporation of PPP. Additionally, the emphasis on infrastructure and the general desire for global economic expansion go hand in hand (Hodge et al., 2017). PPP arrangements received investments totaling 469.82 billion US dollars between 2015 and 2019, which were split among 1,917 projects. They cover the use of facilities by the public sector or users, and they are signed by parties from the public and private sectors. Payments are scheduled during the contracts' lifetime (Lima et al., 2021).

One major barrier to efficient service delivery in many developing nations is corruption in the public sector. Corruption permeates every aspect of life, from launching a new business to obtaining a passport to visiting a doctor, and it can impede the fair distribution of goods and services to residents. Different forms of corruption include hospital staff pilfering medications intended for charitable donations, officials asking civilians for bribes to carry out basic tasks, and bureaucrats getting paid for work they don't accomplish (Heydari et al., 2021).

On the other hand, the model (PPPs) is regarded as a key tool for completing mega projects worldwide. The PPP model is increasingly used to carry out large-scale infrastructure projects that were previously exclusively supported by the government (Akomea-Frimpong et al., 2021). To comprehend the many project stakeholders' particular views of risk and how their interactions can yield varied project outcomes, practitioners on PPP projects would need to adopt an interpretative technique. This would require them to interact closely with the stakeholders (Loosemore & Cheung 2015).

Furthermore, notable focus has been paid to stakeholder collaboration as a means of improving risk management. The effective operation of risk management is also seen to depend on reporting and communication about risks both inside and across organizations. Likewise, it has been argued that sustained support for the risk management role from all parties involved is crucial. Since PPP projects' objectives and requirements are closely tied to risks, which must be examined from a life-cycle perspective, a thorough assessment of risks and requirements is required, especially when adequate risk assessment is only achievable through the use of the right tools and techniques (Mazher et al., 2022).

V. CONCLUSION

Leveraging technology breakthroughs, adjusting to emerging risks, developing an accountable culture, and taking a forward-thinking approach are all necessary to strengthen financial risk governance and compliance in the United States. In a constantly changing global financial market, this roadmap which emphasizes sophisticated risk management, regulatory modernization, and a robust compliance culture is crucial to maintaining economic stability. Overall, our review indicates that although financial stability committees are intended to foster increased cooperation, their inability to directly establish macroprudential policies will prevent most of them from significantly improving financial stability. Effective risk management techniques are, therefore, essential in maintaining an economically stable nation: the US as a case study. Likewise, PPP projects have been analyzed as a major tool in fostering the ability of US organizations and institutions to adopt the systems thinking approach through risk governance for economic stability.

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