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Via Email to regs.comments@federalreserve.gov

Ms. Anne E. Misback, Secretary
Board of Governors of the Federal Reserve System
20th Street and Constitution Avenue N.W.
Washington, D.C. 20551

RE: Request for Comment on Proposed Guidance on Supervisory Expectation for Boards of Directors [Docket No. OP-1570]

Ladies and Gentlemen:

State Farm Mutual Automobile Insurance Company ("State Farm Mutual") writes in response to the current proposed guidance ("Proposal") issued by the Board of Governors of the Federal Reserve System (the "Board of Governors") addressing supervisory expectations for the board of directors of savings and loan holding companies ("SLHCs"). State Farm Mutual owns a federally chartered thrift, State Farm Bank, F.S.B., and is pleased to offer the comments below.

I. General Comments to Proposed Guidance

A. The Proposal Recognizes the Need for Appropriate Distinction Between the Role of the Board of Directors and Management.

State Farm Mutual applauds the Board of Governor's efforts to diminish the number and types of issues brought to the attention of boards of directors at SLHCs, especially for those boards of directors that are not directly responsible for the day to day operations of a thrift. The Board of Directors of State Farm Mutual oversees an operating insurance company, the parent of an insurance group and the SLHC. We agree with the sentiments expressed in the U.S. Department of Treasury June 2017 Report that "reassessing regulatory requirements on a banking organization's board of directors" requires recognition that "One of the most fundamental elements of the governance framework is the separation of duties between management, responsible for day-to-day operations of the business, and the Board, responsible for oversight…."[1] Regulatory obligations imposed on boards of directors must not crowd out the

[1] The US Department of the Treasury, June 2017 Report entitled: A Financial System which Creates Economic Opportunities Banks and Credit Unions at 61.

core function of a board—oversight; doing so "'detracts from effective governance by potentially reducing the Board's ability to focus on its core oversight functions.'"[2]

Specifically, the Treasury report indicated that "over 800 provisions in law, regulation, and agency guidance … impose obligations on bank Boards," the "too voluminous" and not "appropriate[ly] tailor[ed]" weight of which "crowds out time that should be allocated to oversight of … business risk and strategy" and "blur[s] the appropriate lines between management and Board duties."[3]

We therefore appreciate the Board of Governor's acknowledgement that voluminous prescriptive duties placed on boards of directors may diminish a board's ability to achieve other goals. This is especially the case when at consideration are the supervisory expectations of Boards of SLHCs in which affiliates of the SLHCs also maintain separate Board of Directors and/or management. We support this Proposal's intent to limit the burden placed on board directors and provide clear division of responsibility between directors and management. We encourage the Board of Governors to perform a complete review of regulators' expectations of and guidance applicable to boards of directors, including state insurance regulatory bodies, other federal banking regulators, and other regulatory bodies such as the Securities and Exchange Commission for publicly traded entities.

The Proposal also rightly recognizes the distinction between the roles and responsibilities of management and a board of directors. Abundant business scholarship and common law alike provide a plethora of detail of the current understanding of the inherent distinction between these roles. In general terms, the board of directors focus principally on the "core responsibilities" of guidance, strategic issues, CEO performance and succession, and performance oversight (including risk management). Management, on the other hand, implements the business strategy and runs day-to-day operations.

This is why we believe that the development of board effectiveness standards subject to assessment by the Board of Governors is inconsistent with these premises and will interfere with boards' core responsibilities and lead to the blurring effect that undermines the Proposal's stated goals. Specifically, we have concerns that this Proposal:

- Does not adequately acknowledge nor address the inappropriateness of applying federal bank-centric standards to an SLHC that is an operating insurance company or the holding company in an insurance holding company system. The McCarran-Ferguson Act clearly delegates the authority to regulate the business of insurance to the states. This Proposal appears to have the strong potential to impair or conflict with state insurance laws on governance. Specifically, the Proposal does not acknowledge the authority of the states, under McCarran-Ferguson's reverse preemption regime, to establish and enforce corporate governance requirements and standards for insurance holding companies. These requirements are found in many sources, including but not limited to NAIC's Model Holding Company System Act, Corporate Governance Annual Disclosure Model Act and Regulation, and Financial Condition Examiners Handbook. By ignoring these governance authorities enforced by the primary regulators of insurance holding companies, the Proposal creates the strong likelihood of subjecting entities like ours to conflicting legal requirements and standards.

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[2] Id.

[3] Id. at 61.

- Does not recognize the very limited instances where corporate governance of the SLHC should be an issue for assessment, especially since the underlying depository institution board of directors and management, here those of State Farm Bank, are given the task of corporate governance for that entity including as it relates to financial safety and soundness;
- Potentially undermines and creates new uncertainty for well-settled standards of corporate governance developed under both state statutes and common law;
- Does not recognize that entities vary in size, complexity, and culture all of which informs the basis for a company's governance, risk culture, and risk management program;
- Does not consider the potential separate roles of the SLHCs operating as a regulated legal entity from that of the affiliated separate legal entity that is operating as a thrift;
- Goes well beyond guidance in creating new obligatory standards in both structuring internal management and delineating management responsibilities in reporting to boards of directors; and
- Places mandates relative to risk management on boards of directors which should be the function of management.

These concerns are explained and elaborated on in more detail below.

B. The Proposal Should Recognize and Tailor Itself to the Entire Regulatory Landscape Applicable to Supervised Entities.

State Farm Mutual, the regulated SLHC which serves as the holding company for the State Farm group of companies, is not simply a savings and loan holding company. It is also a regulated insurance company, subject to comprehensive regulation by the Illinois Department of Insurance (the "Illinois Department"). The Model Holding Company System Act, adopted in Illinois and other States subjects all of State Farm Mutual's subsidiaries, either as domestic Illinois corporations or as assets of State Farm Mutual, to comprehensive holding company system reviews and specific individual examination by the Illinois Department and other state insurance regulators. Under insurance holding company laws, all aspects of State Farm Mutual and its affiliate's businesses are subject to close regulatory scrutiny including operations, material and/or specific transactions within the holding company systems, investments, accounting, and corporate governance.

The Proposal should recognize and adapt to the thorough prudential or functional regulatory framework that already applies in the particular instance where a regulated insurer serves as the parent for a regulated thrift. Functionally regulated insurance holding companies like State Farm Mutual that are both a SLHC and an operating insurance company should not be subject to the Proposal's top-to-bottom duplicative governance regime. In this case it is an additional regulatory burden for the board of directors and management that is distracting, unnecessary and creates potential conflicts. While we recognize that Congress intended Federal regulation of SLHCs to provide an additional layer of supervision and, in certain instances, capital regulation, this must be reconciled with Congress's empowerment of State insurance commissioners as the primary functional regulator of those SLHCs that are regulated insurers. Existing functional regulation should not be ignored, duplicated or displaced where it is working.

We believe the Board of Governors should propose utilizing or seek comment on how to utilize state regulation for the specific case of insurance-based SLHCs headed by regulated insurers not only for corporate governance issues being discussed here but for all other facets of supervision. Should there be any assessment by the Board of Governors related to corporate governance it should be limited only to a board's effectiveness with respect to functioning as an SLHC. Any assessment in relation to the insurance-based SLHC board's oversight of management adherence to the board's established guidance and strategic decisions should be related to being a SLHC and controlling a thrift and not an assessment of the board's duty in carrying out its other associated responsibilities (*i.e.*, effective oversight of insurance operations).

With respect to corporate governance generally, a developed body of corporate law provides ample guidance that every large company dedicates substantial internal and external compliance resources to studying and meeting. Between the volumes of litigation and court activity related to corporate governance in our country, as well as other regulatory bodies' involvement (such as insurance commissioners, secretaries of state and the Securities and Exchange Commission), we view the layering of affirmative board effectiveness standards as both unnecessary and potentially a source of conflict between different corporate governance laws and regulations. There is a high potential of unintended consequences when common law understandings of corporate governance are overlaid with a nebulous regulatory assessment of the same.

We further encourage the Board of Governors to prioritize consideration of the balance between regulator and company responsibility. Boards of directors, not regulators, are responsible for the ultimate success of their companies. No amount of regulatory oversight can substitute for—or produce—effective corporate governance; attempts to over-regulate governance may actually impede effective board oversight of management.

Regulatory guidance issued by the Board of Governors should be specifically tied to promoting the safety and soundness of a savings and loan holding company for the limited purpose that regulatory authority exists, not only with deference to and coordination with functional regulators, but also with deference to the fundamental role of a corporation to govern itself in a manner that adapts to its particular circumstances. Simply put, there is a need for a balance between regulator and company responsibility and judgment. Here, measuring financial safety and soundness of a SLHC as a potential source of strength for the thrift is more regulatory in nature, while generally overall governance issues are primarily the province of the holding company, and can be better implemented by effective boards than by even the most effective regulator. Scrutiny of the latter by a regulator should only come to pass in the event there is some noted shortcoming of management to carry out the stated guidance and strategic issues established by the board of directors, which warrants such intrusion given the Board of Governors limited regulatory purpose related to SLHCs, and when not already the province of the functional regulator in the case of an insurance SLHC.

C. Corporate Governance and Board Effectiveness are Unique to an Entity and not Amenable to Blanket Standards.

We are in agreement with the Board of Governor's statement in the proposal that "applying standardized expectations for boards of directors fails to take into account differences in firms' activities, risk profiles, and complexity, and potentially prevents a board from achieving maximum effectiveness in meeting its core responsibilities." However, the Proposal, by prescriptively outlining criteria for board effectiveness subject to assessment, seems to contradict the quoted language.

The entire concept of effective governance requires highly individualized entity-by-entity analysis. Many courts have recognized one-size-fits all approaches or mandates with respect to corporate governance are inappropriate. Instead, most general laws of incorporation in the U.S. are enabling in nature, as opposed to prescriptions or mandatory terms, under the philosophy that "the public good is advanced by the provision of an inexpensive mechanism that allows all individuals to achieve the benefits that the corporate form provides (most importantly, centralized management and entity status, with its characteristics of indefinite duration and separately salable share interests) through establishing management and governance terms that appear advantageous to those designing the organization. Thus, unlike the corporation law of the nineteenth century, modern corporation law contains few mandatory terms; it is largely enabling in character." *Matter of Appraisal of Ford Holdings, Inc. Preferred Stock,* 698 A.2d 973, 976 (Del. Ch. 1997).

Effective corporate governance and boards in particular exist from one entity type to another- be it a publicly traded company, a small privately held venture, or a mutually held corporation. How a board of directors operates effectively varies with the nature of the business, the industry in which it operates, the strategic options, the size and maturity of the organization, the corporate culture, the talents and background of the board members, as well as the talents and personalities of the directors, the CEO, and management. Because the circumstances drive the manner of gaining effectiveness, we believe standardization is not appropriate.

D. Guidance on Risk Management Frameworks Must Allow for Business Judgment

While the proposed guidance provides an analysis of the current regulatory guidance in an effort to lessen the current burden placed on boards of directors, the guidance actually has the potential to increase the burden via the articulation of board duties with respect to risk management. Further, the guidance effectively codifies the relationship between the board and company risk officers. We believe that codification on this issue has historically not occurred because of the variances in corporate entity structure, management, type (public v. private), and the resulting public policy bias against prescriptive regulation of the American corporate form. The development of a risk management framework and the allocation of duties between senior management and boards of directors relative to that framework have historically been crafted and articulated **within a corporate entity itself**. It is an aspect of the internal affairs of the entity, and the board of director's actions are subject to deference. Indeed, the deference to the business judgment of a board in the absence of fraud or conflicts of interest is a basic tenant of the corporate form. "The business judgment rule serves to protect and promote the role of the board as the ultimate manager of the corporation. Because courts are ill-equipped to engage in post hoc substantive review of business decisions, the business judgment rule 'operates to preclude a court from imposing itself unreasonably on the business and affairs of a corporation.'" In re Walt Disney Company Derivative Litigation, 907 A.2d 693, 746 (Del. Super. 2005). Courts do not presume to interpose their own opinions about how a corporation should address those issues, and neither should regulators absent some specific factor that calls for regulatory interposition. In short, supervision of such frameworks must allow for business judgment by a board of directors and senior management, deference to functional regulators, and latitude for the unique facets of each institution.

II. Responses to Questions

(1) How should the proposed BE guidance and refocusing of existing supervisory guidance be adapted to apply to boards of the U.S. intermediate holding companies of foreign banking organizations and state member banks?

We take no further position on this question, other than to reiterate the points made above about board effectiveness standards being misplaced in light of unique entity circumstances and concerns about regulatory over-reach by imposing standardization in the context of a corporate governance issue.

(2) What other attributes of effective boards should the Board assess?

The Board of Governors should not assess attributes of effective boards, unless there is a demonstrated reason to delve into possible lapses in the governance framework. As noted above, we are concerned with the Board of Governor's view that there is necessarily a need to create burdens on institutions and the regulator by assessing boards for effectiveness, an exercise that is inherently subjective. We are also concerned with the perceived need to establish standards to measure effectiveness in regulatory guidance. Further to this point, any regulatory assessment must be conducted by experienced examiners who understand the finer points of board functions and business judgment. An inexperienced examiner will potentially make judgments solely based on books and records, process and procedures, thereby incenting directors of a board to devote time and resources in carefully documenting everything they do, instead of creating a supervisory framework which supports focus on core responsibilities instead of documentation. We believe the issue should be raised only in circumstances that would clearly suggest there is a lapse in board oversight of management, and should recognize the unique case-by-case evaluation that must follow. If the Board of Governors persists in assessing board effectiveness, unintended and harmful consequences are certain to arise.

(3) Should boards of firms subject to the proposed BE guidance be required to perform a self-assessment of their effectiveness and provide the results of that self-assessment to the Board?

No. We are not aware of any other law, regulation, or regulator in the U.S. that requires a board to perform a self-assessment, and find no basis whatsoever for the Board of Governors to consider this mandate. While we believe in the fundamental benefits of a board self-assessment, it should be a tool to utilize as the board in its judgment determines is appropriate based on the board's particular needs. Imposing such a mandate intrudes on the judgment of the board of directors to determine the manner in which to gauge its own effectiveness. Further requiring submission of such an assessment would likely undermine the goal of obtaining candid and meaningful responses. Pro forma templates and evaluations may limit the depth at which some boards contemplate relevant matters.

(4) Would any parts of this proposal conflict with effective governance of insurance and commercial savings and loan holding companies? If so, what adjustments to the proposal would be warranted?

Yes, there is a large potential for conflicts with common law standards, state regulatory standards, and other standards by other regulatory bodies. Insurance corporations are enabled under state insurance laws and guided by principles of state statutory and common law. Board of Governors intrusion into this area is quite likely to create confusion and conflict with these well-established principles and laws. Please see our foregoing comments.

(5) Is the proposed guidance on the communication of supervisory findings clear with respect to the division of responsibilities between the board and senior management?

While we find the stated intention clear (i.e., to further distinguish between the responsibilities of the board and senior management), we do not find clarity in how that intention is to be carried out in other SRs, with the exception of SR 13-13.

(6) What Federal Reserve supervisory expectations for boards are not included in Table A, yet interfere with a board's ability to focus on its core responsibilities and should be included in the proposal? Should such expectations be rescinded or revised? If revised, how?

There is lack of clarity with respect to the identified SR letters in Table A, as the table does not specify whether the expectations outlined therein would be rescinded or revised, and if to be revised, in what manner. It is possible that there are other SR letters that should be rescinded or revised. We are supportive of efforts to comprehensively address all SRs and other guidance so as to ensure that boards of directors are not unduly burdened and can focus on their core oversight responsibilities. This means ensuring no conflicts with or impairments of state insurance laws and regulations.

Thank you for the opportunity to comment on these very important issues. We are happy to discuss these issues with you further at your convenience.

Sincerely yours,

Stephen McManus

Stephen McManus, Senior Vice President and General Counsel
State Farm Mutual Automobile Insurance Company