November 20, 2017

Via Electronic Submission

Ms. Ann E. Misback
Secretary
Board of Governors of the Federal Reserve System
20th Street and Constitution Avenue, NW
Washington, DC 20551

Re: Proposed Guidance on Supervisory Expectations for Boards of Directors, Docket No. OP-1570

To Whom It May Concern:

The Financial Services Roundtable[1] ("FSR") appreciates the opportunity to comment on the Federal Reserve Board's ("FRB" or the "Board") proposed guidance on supervisory expectations for boards of directors (the "BE guidance").[2] Our comments are divided into two sections: (1) general comments, and (2) responses to the questions posed by the Board in the notice accompanying the proposed BE guidance.

I. General Comments

FSR supports the issuance of the BE guidance, *and the Board's plans to conform* supervisory letters and regulations to the BE guidance.

For some time, the members of FSR have been concerned about regulatory and supervisory expectations that fail to properly distinguish between the role of directors and senior management and that divert the attention of directors from their core responsibilities. Basic principles of corporate governance call for boards to provide overall direction and oversight to an organization, which is a role distinct from senior management. In other words, directors are not expected to — and should not be required to — manage the day-to-day affairs of a company. Yet, current regulatory and supervisory expectations have substantially increased the amount of time directors are required to devote to meeting technical regulatory requirements, reducing the amount of time boards can spend on core matters of business strategy and development.

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1 The Financial Services Roundtable represents the largest integrated financial services companies providing banking, insurance, payment and investment products and services to the American consumer. Member companies participate through the Chief Executive Officer and other senior executives nominated by the CEO. FSR member companies provide fuel for America's economic engine, accounting for $54 trillion in managed assets, $1.1 trillion in revenue, and 2.1 million jobs. Learn more at FSRoundtable.org.

2 82 Fed. Reg. 37219 (Aug. 9, 2017).

Moreover, certain regulatory and supervisory expectations have been especially troubling as they seem to carry the expectation that the board will "make certain" or "ensure" certain organizational outcomes.

The preamble to the BE guidance states that it is intended to address these concerns by enabling directors to focus on "core responsibilities," and by ensuring that regulatory and supervisory expectations "better distinguish" between the roles and responsibilities of an institution's board and its senior management.[3] Given the stated intent of the BE guidance, FSR supports the issuance of the guidance, and the Board's related plans to conform supervisory letters and regulations to the guidance.

We also strongly encourage the Board to engage with the Federal Deposit Insurance Corporation and the Office of the Comptroller of the Currency to align the supervisory expectations of those agencies with the BE guidance. While we do not believe the Board should wait for the other agencies to act before issuing its guidance, a full realignment of board responsibilities as envisioned by the proposed guidance cannot be realized unless and until the Board and the other federal banking agencies harmonize their supervisory expectations for boards, and all relevant supervisory letters and regulations are replaced with a set of core principles.

> FSR recommends that the final guidance explicitly state that it is intended to be a *"principles-based" approach to governance, and will be applied proportionately based* upon an *institution's risk profile, size, complexity, and other characteristics* taking into account the business judgment of the board.

The impact of the BE guidance on corporate governance will be determined by the manner in which it is interpreted by regulated institutions and supervisors. As discussed further below in section II, the proposed attributes of an effective board should not be interpreted as a new compliance check-list that frustrates the intent of the guidance. To avoid such a result, FSR recommends that the final guidance explicitly state that it is intended to be a "principles-based" approach, and will be applied proportionately based upon an institution's risk profile, size, complexity, and other characteristics. Furthermore, the guidance should state that as a "guidance" it does not impose binding requirements on boards. These clarifying statements would help to ensure that the guidance is applied flexibly and gives appropriate deference to boards of directors to exercise business judgment in tailoring their practices and approach based on institution-specific considerations.

Such clarifying statements are consistent with the view expressed in the preamble to the BE guidance 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."[4] Appropriate deference to the business judgment of the board also aligns with existing corporate law which recognizes the business judgment rule. A hallmark of the business judgment rule is that board directors, who have been duly elected by an institution, can most ably determine what is in the

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[3] Id.

[4] 82 Fed. Reg. 37129, 37220 (Aug. 9, 2017).

best interest of the institution when making business decisions in the exercise of their fiduciary obligations. Similarly, FRB supervisors should give appropriate deference to boards when making governance decisions, which naturally encompass business decisions related to risk-taking and strategic direction. In summary, FSR requests that the final guidance accorded an appropriate degree of deference to the business judgment of boards.

FSR recommends that the Board take steps to ensure the proposed large financial institution (LFI) rating system is aligned with the goals of the BE guidance.

FSR is concerned that making board processes a significant part of a financial institution's supervisory rating, as is proposed in the new LFI rating system, could undercut the goals of the BE guidance. For example, a literal application of the guidance by an examiner could result in an increased compliance burden on boards as directors conclude that they need to fully document processes in order to meet examiner inquiries. Perhaps more importantly, a literal application of the guidance by an examiner could cause boards to avoid adopting innovative or unique governance processes so as not to be outliers that could target supervisory scrutiny. These concerns underscore the need for the Board to ensure that examiners understand the intent of the guidance and the need to apply it flexibly and with appropriate deference to individual institutions' boards. Thus, FSR recommends that the Board take steps to ensure the proposed large financial institution (LFI) rating system is aligned with the goals of the BE guidance. FSR also recommends that the Board not conduct stand-alone examinations of board processes, but rather continue to assess board effectiveness as part of normal supervisory reviews of other substantive areas.

FSR recommends that the BE guidance be revised to clarify the role of board committees in corporate governance.

As proposed, the BE guidance does not explicitly address the use of board committees. This oversight could cause some examiners to conclude that boards may not delegate functions to committees. We recommend that the guidance be revised to clarify the role of board committees in corporate governance. More specifically, we proposed that the final guidance include a rule of construction that provides that when the term "board" is used, this term may be interpreted to mean: (1) the full board; or (2) an appropriate committee of the board.

FSR supports the *Board's proposal to revise existing requirements on communications of* supervisory findings to boards of directors.

Under current Board policy, matters requiring attention (MRAs) and matters requiring immediate attention (MRIAs) that are identified in examinations must be addressed to the board of directors for corrective action. [5] The Board is proposing to replace this policy with a new policy that would require most MRAs and MRIAs to be addressed by senior management in the first instance, not the board.

[5] The Federal Reserve Board, SR 13-13/CA 13-10, Supervisory Considerations for the Communication of Supervisory Findings (June 17, 2013).

FSR supports the Board's proposal to revise existing requirements on communications of supervisory findings to boards of directors. This change in policy would help a board to focus on core responsibilities. At the same time, this policy change would not diminish the duty of a board to oversee the sound operation of an institution. The proposed policy clearly states that a board remains ultimately responsible for holding senior management accountable for remediating supervisory findings.

The proposed policy also requires that an MRA or an MRIA be directed to the board if the MRA or MRIA relates to "board governance structure and practices". We agree that matters of board governance structure and practices should be brought to the attention of a board. We recommend, however, that this policy be interpreted narrowly, so as not to have this exception override the intent of the policy. In other words, it could be argued that almost any MRA or MRIA ultimately implicates board governance. To avoid this result, the policy statement could clarify that the exception applies to the direct actions of a board.

FSR recommends that the BE guidance be applied on the basis of a risk assessment, not an arbitrary asset size.

In conjunction with the issuance of the BE guidance, the Board is proposing to revise certain supervisory letters that impose supervisory expectations on boards of directors for bank holding companies and savings and loan holding companies.[6] In doing so, however, the Board is proposing to distinguish between companies with more than $50 billion in assets and those with less than $50 billion in assets. For holding companies with more than $50 billion in assets, the revisions would be designed to align the supervisory letters with the proposed BE guidance. For holding companies with less than $50 billion in assets, the revisions would align with the supervisory expectations set forth in SR 16-11, which currently provides supervisory guidance for assessing risk management at such institutions.

FSR supports the tailoring of regulations and supervisory practices. Such tailoring, however, should be based upon an assessment of risk, not arbitrary asset thresholds or the application of banking standards to insurance companies supervised by the Board. Reliance on asset size as a sole factor in identifying risk is incomplete, overly simplistic, and prone to error. The use of asset thresholds also results in perverse "cliff" effects as institutions below the threshold take actions to avoid crossing the threshold, and institutions that cross the threshold are subject to heightened requirements even though their risk profile has not changed. Similarly, several of FSR insurance company members have experienced difficulties in examinations with the application of bank-centric assessments of risk that are misplaced when applied to the business of insurance. FSR recommends that the BE guidance be applied on the basis of a risk assessment that is appropriately aligned with each company's operations and activities.

II. Responses to the Board's Questions

The Board has invited comments on several aspects of the proposed BE guidance. In this section of our letter, we repeat the questions and provide FSR's responses.

[6] The Board has identified 27 supervisory letters that fall into this category. *Supra* n. 2 at 37221.

Question One: The Federal Reserve is considering applying the proposed BE guidance to U.S. intermediate holding companies of foreign banking organizations. 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 banks and state member banks?

If the Board decides to apply the BE guidance to intermediate holding companies, the guidance would need to be modified to address the specific structure and operations of an intermediate holding company. To achieve this, refinements would be needed in each of the attributes. We recommend that, if the Board decides to extend the guidance to intermediate holding companies of foreign banks, the guidance be issued for public comment to help ensure that it is appropriately refined for intermediate holding companies.

Question Two: What other attributes of effective boards should the Board assess?

FSR does not propose any other attributes for inclusion in the guidance. However, as noted above, we are concerned about the manner in which the attributes will be interpreted and applied by supervisors. It would frustrate the intent of the BE guidance if the attributes are not applied flexibly with appropriate deference to boards to ensure that the guidance does not become simply a "check-the-box" exercise for institutions and supervisors. Therefore, FSR recommends that the Board give supervisors sufficient instruction into the intent of the BE guidance, and closely monitor its implementation to ensure that it achieves its stated intent. We also recommend that in finalizing the BE guidance the Board clarify the matters discussed below.

Setting Clear, Aligned and Consistent Direction

This attribute requires boards to guide the development and approve a firm's strategy and risk tolerance. In performing this function, it is important that boards engage with senior management, and that the board be expected to "oversee" and "approve" strategies and plans rather than "set" or "establish" strategies and plans. Therefore, we recommend that the BE guidance be modified to state that "An effective board of directors guides the development of, and oversees and approves, *the firm's strategy and types and levels of risk* the firm is willing to under*take based upon engagement with senior management."*

Additionally, we recommend that the final guidance clarify that the policies assessed by directors under this attribute should only be those the board is required to review by law or regulation, and not detailed policies and procedures, such as the firm's audit plans.

Actively Managing Information Flow and Board Discussions

As proposed, we believe that this attribute is overly prescriptive. We agree that boards have a role in setting agendas and determining the scope of information they receive and the manner in which it is provided. However, under Delaware law boards are entitled to be protected when relying on information provided to them by management. Therefore, the BE guidance should not impose an obligation on board's to "actively" manage information flow.

Additionally, every board has a different approach to setting agendas and determining the scope of information it should receive and the manner in which that information is to be provided. Accordingly, this attribute should be interpreted flexibly and not be interpreted to require a uniform approach to the development of agendas, the scope of information provided, or the manner in which that information is provided. For example, the attribute should not be interpreted to require an institution to keep records of every directive from a board to senior management regarding information flow. Similarly, all directors should not be expected to have a role in setting board agendas. That is a role that could be carried out by a lead independent director or board chairman. Furthermore, the final guidance should clarify that when a board member seeks information from management, that request may be channeled through the lead director or the chairman of the board to avoid ad hoc and potentially conflicting engagement between board members and management.

Holding Senior Management Accountable

Boards do have an obligation to holds senior management accountable for the operations of the organization. However, the manner in which this obligation is exercised can have a material impact on the culture of an organization. If examiners interpret this obligation to require detailed process flows and spread sheets of every operational risk loss event, and then require a determination of which managers are "accountable" for these risks, the attribute could engender a culture of fear and retribution within the organization. Thus, we urge the Board to clarify that "accountability" should be interpreted flexibility and be designed to encourage management to remain motivated and engaged.

This attribute also encourages open and robust discussions at board meetings. We recommend that the attribute be revised to clarify that this does not require a detailed record of a board meeting and every question posed by a director. A board's effectiveness should be judged on its overall operations, not just a review of board minutes. This current supervisory expectation of detailed minutes inhibits the free flow of discussions that should occur at board meetings.

Additionally, the Board should clarify that for purposes of this attribute, "senior management" refers to the chief executive officer, and perhaps the chief risk officer and chief audit executive, but not the chief financial officer or the heads of business units. As a general matter, boards cannot hire or fire anyone other than the chief executive officer and should not be responsible for establishing performance objectives for individuals not directly accountable to them. Moreover to the extent that a board sets performance objectives and succession plans for senior management, the attribute should clarify that such objectives can be set by a committee of the board.

Support for Independence and Stature of Independent Risk Management and Internal Audit

We recommend that this attribute include some examples on how an institution's risk management function can demonstrate sufficient independence. We also recommend that boards not be expected to identify "specific instances or decisions" where the independence and stature

– or lack thereof – of the independent risk management and internal audit have materially impacted business deliberations, decisions, practices, and/or the firm's strategy. This likely would result in recording and examination procedures that would be at odds with a more principles-based guidance.

Finally, we recommend that the description of the role of the audit committee should clarify that this committee's functions also must align with the SEC and SRO rules.

Maintaining a Capable Board Composition and Governance Structure

We appreciate that the BE guidance is not intended to impose a "one-size-fits-all" requirement on institutions. The composition and governance structures of an institution should match the size and complexity of the institution. This attribute could be further clarified by noting that the composition of the board ultimately is based upon a vote of the shareholders.

> Question Three: Should boards be required to perform self-assessments of their effectiveness and provide the results of that self-assessment to the Board? If so, what requirements should apply to how the board performs the self-assessment? Should such self-assessments be used as the primary basis for supervisory evaluations of Board effectiveness?

Self-assessments can be an effective tool, and many boards already engage in self-assessments. The New York Stock Exchange (NYSE) requires boards of listed companies to undertake an annual self-assessment to determine whether the board and its committees are functioning effectively. Similarly, many non-NYSE companies also perform self-assessments as a matter of good corporate practice. Nonetheless, we strongly caution against a new requirement for institutions to conduct self-assessments and to share the results with regulators. Should self-assessments become a regulatory requirement, we are concerned that they would become less candid and less useful, especially if there is any potential for the assessment to become public. Moreover, self-assessments currently take different forms at different institutions, and, in many cases, may be performed by interviews rather than written reports. We believe it is important for institutions to be able to design and implement their own self-assessment procedures based upon their own structure and operations

> Question Four: Does the proposed guidance conflict with the effective governance of insurance and commercial savings and loan holding companies?

We have not identified any conflict.

> Question Five: Is the proposed rewrite of SR letter 13-13CA letter 13-10 clear?

As noted above, FSR recommends that the policy statement be clarified to provide that the exception for taking an MRA or MRIA to the board only when it relates to board governance structure or practices apply to direct actions by a board. Otherwise, this exception could be interpreted too broadly and override the intent of the policy.

Question Six: Are there other supervisory expectations not included in the 27 letters identified by the Board that should be addressed?

We have identified three additional supervisory letters with provisions related to corporate governance that should be conformed with the BE guidance or SR 16-11, as applicable. Those letters are: SR 15-18, Guidance on Supervisory Assessment of Capital Planning and Positions for LISCC Firms and Large and Complex Firms; SR 15-19, Federal Reserve Guidance on Supervisory Assessment of Capital Planning and Positions for Large and Noncomplex Firms; SR 13-1/CA 13-1, Supplemental Policy Statement on the Internal Audit Function and its Outsourcing; and SR 11-7, Guidance on Model Risk Management.

Additionally, as we noted above, a full realignment of board responsibilities as envisioned by the proposed guidance cannot be realized unless and until the Board and the other federal banking agencies align their supervisory expectations for boards, and all relevant supervisory letters and regulations are replaced with a set of core principles.

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We appreciate your consideration of our comments. Please feel free to contact me via telephone at (202) 589-2424 or email at Richard.Foster@FSRoundtable.org. If you have any questions.

Sincerely yours,

Richard Foster
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Financial Services Roundtable