

Joseph A. Smith, Jr.
Raleigh, NC
Commissioner.smith@outlook.com

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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 Regarding Supervisory Expectations for Boards of Directors
Docket No.: OP-1570

Dear Ms. Misback:

This letter is submitted in response to the request by the Board of Governors of the Federal Reserve System (Board), through a release issued August 3, 2017 (Release), for comments on the above-referenced proposed guidance (Proposed Guidance). The comments set forth below are based on my experience as general counsel of a regional bank holding company, North Carolina Commissioner of Banks from 2002 to 2012 and Monitor of the group of consent judgments commonly known as the National Mortgage Settlement¹ since 2012. In those capacities, I have had occasion to review and assess the risk management and governance structures of financial services firms ranging from small community banks to firms of national and global scale. On the basis of that experience and the analysis below, I respectfully submit the following comments on the Proposed Guidance:

1. The Proposed Guidance addresses only one aspect of a larger and more important issue: the roles and interactions of boards, managements and supervisory agencies in the oversight of financial services firms, particularly large and / or complex firms. It should be revised to more explicitly address board independence and capacity as a supervisory expectation and should be harmonized with the interagency reassessment of the supervisory process contemplated by the recently released report by the Department of the Treasury on financial regulation (Treasury Report).²
2. Board self-assessments should not be mandatory as part of the supervisory process.
3. The provisions of the Proposed Guidance with regard to communication of supervisory findings should either
 - a. Be withdrawn; or

¹ *United States v. Bank of Am. Corp.*, No. 12-cv-00361-RMC, 2012 (D.D.C. Apr. 4, 2012), ECF Nos. 10-14, and related consent judgments.

² *A Financial System that Creates Economic Opportunities: Banks and Credit Unions*, Report of the United States Treasury Department to President Donald J. Trump under Executive Order 13772, available at <https://www.treasury.gov/press-center/press-releases/Documents/A%20Financial%20System.pdf>.

- b. Be amended to (i) address all communication between Board supervisory staff and boards; (ii) continue to require that Matters Requiring Immediate Attention be communicated directly to boards; and (iii) harmonize guidance regarding Matters Requiring Attention with the overall interagency reassessment of the volume and nature of MRAs, MRIAs and consent orders contemplated by the Treasury Report.

A more detailed discussion of the foregoing comments is set forth below.

General Comments

The Proposed Guidance seeks to revise and clarify the Board's supervisory expectations of the boards of directors of firms under its supervision (boards)."³ It is informed by a multi-year review of board practices, particularly boards of the largest firms, which suggests:

that supervisory expectations for boards of directors and senior managements have become increasingly difficult to distinguish ... [such that] boards often devote a significant amount of time satisfying supervisory expectations that do not directly relate to the board's core responsibilities.⁴

The Proposed Guidance would revise Federal Reserve supervisory expectations to address this state of affairs by (i) defining the core responsibilities of boards (Proposed BE Guidance);⁵ (ii) commencing a program to align its supervisory guidance regarding boards with performance by boards of their core responsibilities and (iii) revising protocols regarding communication of supervisory findings (Proposed Communications Guidance).⁶ While I am sympathetic to the Board's intention to clarify the core responsibilities of boards in order to increase their effectiveness, I am concerned that the Proposed Guidance does not adequately address the relationships and interactions of supervisory agencies, boards and senior managements and may, in fact, inhibit such relationships and interactions.

The Proposed Guidance addresses only part of an important and larger issue: the proper roles of supervisory agencies (including the Board) and the boards and senior managements of supervised firms in ensuring the safe and sound operation of such firms and their compliance with applicable laws and regulations. Real or perceived failures by supervisory agencies and boards to perform their oversight roles have been a significant topic in public debates related to the Financial Crisis and subsequent misconduct by supervised firms (*e.g.*, LIBOR manipulation, false account openings). These real and perceived failures have undermined public trust and confidence in both the supervision and corporate governance of financial services firms generally, and large or complex firms in particular. As a result, public policy regarding such firms since the Financial Crisis has weakened supervisory discretion in favor of rigorous legislative and regulatory strictures, and enhanced enforcement by federal and state agencies. The National Mortgage Settlement, under which I have acted as monitor of the mortgage servicing activities of a number of major financial firms, is one of the non-supervisory responses to these failures.

³ *Release*, p. 1.

⁴ *Ibid*, p. 3.

⁵ *Proposed Guidance*, pp.21-26.

⁶ *Proposed Guidance*, pp. 27-29.

A different and better approach to this issue is suggested in a recent report of the United States Department of the Treasury regarding regulation of the US financial system (Treasury Report).⁷ The Treasury Report agrees with the Proposed Guidance with regard to clarification of the roles of boards and senior managements.⁸ However, the Treasury Report differs from the Proposed Guidance when it recommends that boards:

should be held to the highest standards when developing and implementing comprehensive regulatory compliance procedures and should hold management to the same standards. This would of course involve Boards engaging with regulators and reviewing significant regulatory actions and complaints.⁹

This statement of board expectations is in the context of an overall goal to “better tailor these aggregate expectations and restore balance in the relationship between regulators, Boards and bank management.”¹⁰ Unlike the Proposed Guidance, the Treasury Report places its recommendations regarding clarification of a board’s responsibilities in the context of an overall reform of supervisory and regulatory practices.

Among the Treasury Report’s recommendations is development of an “improved approach to addressing and clearing regulatory actions in order to limit the sustained and unnecessary restriction of banking activities and services provided to customers.”¹¹ In particular, the Treasury Report recommends an interagency reassessment of the volume and nature of matters requiring attention (MRAs), matters requiring immediate attention (MRIAs) and consent orders.¹² This recommendation is based on complaints from many banking organizations of “multi-year delays in even receiving a plan to clear regulatory actions, which clouds their business activities during such delays.”¹³ My reading of this Treasury Report recommendation is that it seeks to reduce unnecessary regulatory and supervisory details so that boards, senior managements and supervisory agencies can focus on what is most important.

In my view, neither the Proposed Guidance nor the Treasury Report adequately addresses a necessary predicate to the effectiveness of boards: independence and capacity to perform core responsibilities. The Proposed BE Guidance addresses independence of directors rather summarily and indirectly under the topic, “Maintain a Capable Board Composition and Governance Structure,” where it briefly discusses the need for diversity in board membership and includes among director qualifications “expertise, availability, integrity and potential conflicts of interest”.¹⁴ Independence is mentioned under “Holding Senior Management Accountable,” which states that an effective board “has independent directors who are sufficiently empowered to serve as a check on senior management.”¹⁵ The Proposed Guidance does not

⁷ *Op cit*, note 2.

⁸ *Treasury Report*, pp. 61, 62.

⁹ *Ibid*, p. 17. It should be noted that the Treasury report uses the term “Board” in reference to supervised firms’ boards of directors.

¹⁰ *Ibid*.

¹¹ *Ibid*.

¹² *Ibid*, p.65.

¹³ *Ibid*.

¹⁴ *Proposed Guidance*, p.26.

¹⁵ *Proposed Guidance*, p. 24.

address the implications for board effectiveness of the dependence of ostensibly independent boards on bank managements for financial and physical resources and information. This is in contrast to the expectations contained in the Proposed BE Guidance section entitled “Support the Independence and Stature of Independent Risk Management and Internal Audit,” which includes among the board’s core responsibilities review of budget, staffing and systems of such functions.¹⁶

Responses to the Release’s Request for Comment

Based on the foregoing, I submit the following responses to the Release’s request for comments on the Proposed Guidance:

[Question 2] What other attributes of effective boards [than those discussed in the Proposed Guidance] should the Board assess?

The Proposed Guidance should include as a separate supervisory expectation the independence and capacity of boards, particularly their non-management directors, to perform their core responsibilities. The BE Guidance should be revised to include a separate section on this issue or the sections entitled “Holding Senior Management Accountable” or “Maintain a Capable Board Composition and Governance Structure” should be expanded to more fully address board independence and capacity. Such revision should include a discussion of how board structure, staff support, budget and authority contribute to the independent and effective performance of core responsibilities. It should also make clear that boards are authorized to obtain information from sources other than senior management, including particularly contact with Board supervisory personnel.

[Question 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? If so, what requirements should apply to how the board performs the self-assessment? Should such self-assessments be used as a primary basis for supervisory evaluations of board effectiveness?

Board self-assessments should not be required.

A required board self-assessment to be included in the supervisory process would not improve the effectiveness of the boards of supervised firms. It would create a cottage industry of consultants to structure and guide such activities and new work for lawyers advising on the potential liability of directors participating in such activities. The inclusion of board effectiveness in the Large Financial Institution Rating System is an important improvement in the supervision of such firms. Enhanced guidance about what is expected of boards in terms of membership composition, committee structure, organization (including charter documents for boards generally and committees of independent directors in particular), budgets and resources would go much further in improving board performance than would a requirement of self-assessments.

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

¹⁶ *Ibid*, p. 25.

The Proposed Communication Guidance restates what I believe to be a generally accepted division of responsibilities between boards and firm managements, regulatory and supervisory matters included: managements are responsible for implementation under board oversight. It goes on, however, to reduce the information available to boards to conduct oversight of supervisory matters as part of their core responsibility to “hold senior management accountable.” The Proposed Communication Guidance replaces Federal Reserve letter 13-13/CA letter 13-10 (SR 13-13), which is based on the proposition that “Communication of supervisory findings to the organization’s board of directors is an important part of the supervision of a banking organization.”¹⁷ It replaces this current guidance by redirecting communication regarding MRAs and MRAs (other than those relating to the board directly) to senior management with the admonition that “it will be the responsibility of senior management to keep the institution’s board of directors apprised of its progress and efforts to remediate MRAs and MRAs.”¹⁸ It is difficult to see how this change addresses the Release’s expression of concern that boards are “inherently disadvantaged given their dependence on senior management for the quality and availability of information.”¹⁹

The Proposed Communication Guidance is at best ambiguous regarding direct interaction between boards and supervisory personnel, such as exit meetings after examinations. The Proposed BE Guidance section on management of information flow includes among a list of information sources outside routine board and committee meetings “discussions with senior supervisors.”²⁰ It is not clear whether the “supervisors” in question are Board or firm personnel. Whatever the answer to this question, under the Proposed Guidance such discussions are out of the ordinary and, accordingly, not part of the Board’s explicit expectations regarding a board’s performance of its core responsibilities.

In light of the foregoing, I would recommend that the Proposed Communications Guidance be withdrawn in its entirety or revised to discuss the totality of communications between boards and Board supervisory personnel and, at the very least, to distinguish between the treatment of MRAs and MRAs. The Proposed Guidance carries forward, with some minor revision, SR 13-13’s definition of the subject matter of MRAs:

- (1) matters that have the potential to pose significant risk to the safety and soundness of the institution;
- (2) matters that represent significant noncompliance with applicable laws or regulations;
- (3) repeat criticisms that have escalated in importance due to insufficient attention or inaction by the institution; and
- (4) matters that have potential to cause significant consumer harm.²¹

It is difficult to see how matters of the kind described above are not of material interest to boards in their performance of their duties under applicable law and how removing direct communication from supervisors enhances the performance of their core responsibilities under the Proposed Guidance. At the very least, the Proposed Communications Guidance should be revised to continue direct written communication with the board with regard to MRAs.

¹⁷ *SR 13-10*, at <https://www.federalreserve.gov/supervisionregulation/srletters/sr1313.htm> Attachment, p. 1.

¹⁸ *Proposed Guidance*, p. 28.

¹⁹ *Ibid*, p. 4.

²⁰ *Ibid*, p.23.

²¹ *Ibid*, p.27.

MRAs may be a different matter. Given the Treasury Report's statement of concern about the volume and nature of regulatory actions (including MRAs) and proposal for interagency action to address this concern, there may be a policy ground to direct communication regarding MRAs to senior managements rather than boards. This change, however, would be better made as part of the interagency reassessment proposed by the Treasury Report.²²

CONCLUSION

I applaud the effort of the Board, in promulgating the Proposed Guidance, to enhance the effectiveness of boards in the performance of their core responsibilities. I am sympathetic to the Board's intention to clarify the responsibilities of boards and senior managements of financial services firms, but believe that such clarification must be done in a manner consistent with overall supervisory reform and in a way that supports public trust and confidence in the corporate governance and supervisory oversight of such firms.

I appreciate this opportunity to comment on the Proposed Guidance and hope that this letter is of assistance to the Board in its important work.

Respectfully submitted,

A handwritten signature in black ink, consisting of several large, overlapping loops and a central vertical stroke, likely representing the name Ann E. Misback.

²² *Treasury Report, op cit.*, note 10