November 15, 2017

Via E-mail

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

Ladies and Gentlemen:

Founded in 1946, the Society is a professional membership association of more than 3,200 corporate secretaries, in-house counsel and other governance professionals who serve approximately 1,600 entities, including about 1,000 public companies of almost every size and industry. Society members are responsible for supporting the work of corporate boards of directors and their committees and the executive managements of their companies regarding corporate governance and disclosure. Our members generally are responsible for their companies' compliance with the securities laws and regulations, corporate law, and stock exchange listing requirements. The Society welcomes the opportunity to comment on the proposed guidance addressing supervisory expectations for boards of directors of banking organizations (the "Board Proposal") issued by the Board of Governors of the Federal Reserve System (the "Federal Reserve") given it has governance implications that are relevant to both banking organizations and public companies generally.

At a recent conference, Federal Reserve Governor Jerome H. Powell explained the intent of the Board Proposal as follows:

"The new approach distinguishes the board from senior management so that we can spotlight our expectations of effective boards. The intent is to enable directors to spend less board time on routine matters and more on core board responsibilities: overseeing management as they devise a clear and coherent direction for the firm, holding management accountable for the execution of that strategy, and ensuring the independence and stature of the risk management and internal audit functions. These were all areas that were found wanting in the financial crisis, and it is essential that boards get these fundamentals right."[1]

The Society commends the Federal Reserve for refocusing its expectations of boards of directors on core responsibilities and for recognizing the distinct roles of the board and management. The increasing burden on boards of directors of banking organizations resulting from the cumulative effect of prescriptive requirements has been well documented. The importance of clearly distinguishing the roles and responsibilities of the board from those of management, however, is important to organizations across industries and regulatory regimes because such roles and responsibilities can be conflated by other constituents of public companies. Overall, the Society views the Board Proposal as a constructive step given its welcome emphasis on focusing the attention of boards of directors on core responsibilities. The Society is providing comments on the Board Proposal to help the proposal achieve its intended purpose of improving the effectiveness of the board.

Flexibility in Establishing the Corporate Governance Framework

We believe that the Board Proposal can be read in many instances as expecting or requiring a uniform or standardized approach to corporate governance. Each firm's corporate governance framework should reflect its particular activities, risk profiles and complexity. Governor Powell, in commenting on the guidance, noted:

"Our new proposal will move to a principles-based approach. We have identified five common attributes that effective boards should exhibit, and for which we will have high expectations. This principles-based approach recognizes that large firms have a broad range of business models, structures, and practices. While we want to be clear about our expectations, we also want to give directors the flexibility to meet them in a manner that works for their particular boards."

We believe that the Board Proposal should be clarified to provide that the examples used to describe the five attributes of an effective Board are not intended to serve as a prescriptive checklist of items that every board must address in substantially similar ways but are instead illustrative examples of how a board could meet its objectives, subject to the particular profile of the banking organization, and following a principles-based approach.

There are many examples throughout this letter of "one size fits all" standards that could be broadly interpreted to apply across all firms. One example is in Attribute B (*Actively Manage Information Flow and Board Discussions*) in which the Board Proposal states that "[d]irectors of an effective board take an active role in setting board meeting agendas." For many boards, however, the independent Chair or the lead independent director may be selected as the director with primary responsibility for soliciting and consolidating input from outside directors to management in setting or approving the agenda and be responsible for liaising between the outside directors and management. The guidance should not be interpreted to suggest that all directors must "take an active role" in "setting" meeting agendas, which we are concerned may lead firms to feel they must engage in a "check the box" exercise to demonstrate compliance with the statement in case it could impact their supervisory rating.

Similarly, it would be contrary to the purpose of the guidance if, for example, boards were to hold "special sessions" in order to "check the box" that they complied with the guidance solely because they believed that doing so could affect their supervisory rating. Thus, the guidance should not require directors to "seek information about the firm and its activities, risk profile, talent, and incentives outside routine board and committee meetings, including through special sessions" if the directors would not otherwise deem it necessary or appropriate to do so.

Additionally, the statement that directors should be able 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" could also be read as creating another check-the-box requirement that the board will be asked to evidence.

The final guidance should emphasize that the board's role is to establish governance practices that the board, in its business judgment, deems appropriate for the particular institution, which may vary from

firm to firm. We believe this should also be reaffirmed for the supervisors that assess individual boards so that a “one size fits all” approach does not develop.

Specific Recommendations

In addition to emphasizing the importance of the no “one size fits all” approach, the Society would like to identify several specific recommendations based on the descriptions of the five key attributes. We believe that in each case our suggestions would further the goals stated in the preamble to the Board Proposal of improving corporate governance overall and increasing efficiency under a principles-based approach.

Policies, Programs and Plans

In Attribute A, the Board Proposal specifically identifies certain policies, programs and plans as “significant”[2] and provides that an effective board “assesses whether the firm’s significant policies, programs, and plans are consistent with the firm’s strategy, risk tolerance, and risk management capacity prior to approving them.” We believe that each institution should be permitted to determine which policies, programs, and plans are “significant” enough to be presented to the board. The Board Proposal should be revised to give institutions this flexibility. Otherwise, this example could result in a “check the box” requirement for boards to assess and approve the materials identified as “significant” by the Board Proposal rather than a principles-based approach to measuring adherence.

As a related matter, existing requirements in the Federal Reserve’s regulations and guidance for boards to review and/or approve detailed and voluminous policies, procedures, plans, and other documents should be rescinded in connection with the Federal Reserve’s comprehensive review of board requirements, as announced in the second part of the Board Proposal. To refocus board attention on core responsibilities under a principles-based approach, it is important to alleviate the burden on boards of being required to review and/or approve documents that do not meet a threshold materiality standard as determined by the particular firm. In many cases boards receive detailed summaries from management that focus on the core elements of voluminous documents and this, along with the ability to pose questions and request additional information, is more effective and consistent with general principles of corporate law and the oversight role of the board.

Appropriate Role of the Board as Compared to Management

Although the Society applauds the Federal Reserve’s efforts to distinguish management’s responsibilities from the board’s responsibilities, certain language in the Board Proposal could be misinterpreted and should be revised to more clearly reflect the oversight role of the board of directors. Rather than describing the role of an effective board as “establishing,” “setting” or “developing” polices, practices or procedures, the role of the board should be to “oversee,” and in appropriate circumstances, “review” and/or “approve,” such matters. For example, the Board Proposal states that the “board is most effective when directors focus on *establishing* a firm-wide corporate strategy and *setting* the types and levels of risk it[3] is willing to take” (emphasis added). In both cases, referring to board

“oversight and review” would better reflect the appropriate roles of the board as compared to senior management in these matters.

We also believe that the guidance should be careful not to overstate the board's ability to control the outcomes of the processes that the board oversees in order to avoid setting unrealistic expectations for boards under a principles-based approach. For example, instead of "making certain that senior management effectively carries out [the approved strategy]" a board would "oversee and evaluate the effectiveness of senior management in carrying out" the strategy.[4]

The Society believes that the Board Proposal's use of the word "active" to describe the role of the board could undermine the Board Proposal's goal to distinguish the role of the board from that of management. Such language may be difficult for firms to interpret and may make it difficult for boards to demonstrate to examiners that they have complied with the guidance. For example, in Attribute B, the proposal states that "[a]n effective board of directors *actively* manages its information flow and its deliberations" (emphasis added). In addition, in Attribute C, the Board Proposal states that an effective board engages in "*robust* and *active* inquiry into" (emphasis added) a list of specific items. These statements appear to expand the board's role beyond its oversight function. Boards of directors are entitled and protected under Delaware and other applicable state laws to rely on the information provided to them by management. It is unclear what actions the board would be required to take to "actively" manage its information flow and its deliberations or to "engage in robust and active inquiry". As a result of this language, boards may feel pressured to inquire into detailed or technical matters that would be outside of their core responsibilities. We endorse the statement in The Clearing House's *Guiding Principles for Enhancing U.S. Banking Organization Corporate Governance* (2015) that:

"The board should not embroil itself in so many details that it interferes with management prerogatives or is limited in performing its general oversight role. Moreover, for the directors to attempt to exercise active day-to-day management or control could create serious safety and soundness issues because the directors normally would lack the experience, expertise, time and knowledge to perform such a role, and could compromise the board's independence, which is a hallmark of sound corporate governance."

Attribute D (*Support the Independence and Stature of Independent Risk Management and Internal Audit*) provides that an effective risk committee would direct "appropriate inclusion of representatives of the independent risk management function on senior management-level committees." In our experience, directors are not involved in directing which members of management sit on management committees nor do we believe it would be within their remit to do so because they are not day-to-day managers of the company.

The Board Proposal should explicitly recognize that, in the appropriate exercise of its oversight duties, the board may determine that any responsibility of the board may be appropriately carried out by a committee of the board (and which committee this shall be). It is an established principle of corporate law that a board may delegate responsibilities to a board committee in order to efficiently allocate responsibility among directors. This principle would fit within Attribute E, and would clarify footnote 9 of the Board Proposal, which states that references to "board" or "board of directors" also refer to committees of the board of directors, "as appropriate."

Senior Management Performance Evaluations

In Attribute C (*Hold Senior Management Accountable*), the statement that an effective board "evaluates the performance and compensation of senior management" should be clarified to provide that each institution may identify which members of senior management are to be evaluated by the board in accordance with existing legal requirements and that institution's particular circumstances, and that it may vary by institution (other than the chief executive officer, who should be evaluated by the board of each institution). As a general matter, it may well be the case that it is appropriate for a board to only be responsible for evaluating members of management who are accountable directly to the board. In addition, it would be more consistent with the appropriate role of the board for the board to "review and approve," rather than "establish and approve," the performance objectives of senior management.

Succession Planning

Relatedly, we agree that the board should be responsible for approving the succession plan for the chief executive officer but, with respect to the chief risk officer, chief audit executive and other members of senior management, the board or its relevant committee should oversee plans for management succession, but not be required to approve succession plans for each role.[5] Under a principles-based approach we would urge that it would be more appropriate to follow the practice we believe is already in place at many public companies for the board to oversee management succession planning, which may include discussions of, and with, particular candidates, but not implement prescriptive approval of succession plans, or an indirect expectation that such plans must be approved, for members of management other than the chief executive officer.

Board Composition and Structure

The Society supports the principles described in Attribute E (*Maintain a Capable Board Composition and Governance Structure*). We caution, however, against being too prescriptive in these areas, which are already highly regulated (for example, by the Securities Exchange Commission and the stock exchanges). Boards of directors must maintain discretion and flexibility with respect to their composition and structure. To highlight an example that may be viewed as overly prescriptive, the Board Proposal refers to "management-to-committee" reporting lines as part of an effective board's governance structure. The Board Proposal should clarify this reference to provide that the guidance is not intended to suggest that boards should be required to have management-to-committee reporting lines beyond those that are encompassed under existing regulations and guidance, which we believe for many firms currently covers the chief risk officer and chief audit executive.

Board Self-Assessments

In response to Question 3 of the Board Proposal's Request for Comments, the Society submits that under a principles-based approach the Board Proposal should not prescribe an additional requirement for boards to perform self-assessments (which are already regulated under stock exchange rules) or provide them to supervisors.[6] Importantly, the results of a board's self-assessments should not be factored into supervisory ratings.

If boards know that results of the self-assessments will be provided to regulators, and thus, that the self-assessments may factor into a firm's supervisory ratings, there is a risk that a firm could be penalized by the candor of the directors in the self-assessment, which would limit the effectiveness of the self-assessments. This, in turn, would undermine effective governance, which should encourage directors to raise potential issues without negative ramifications during the self-evaluation and work with management to resolve them appropriately.

More broadly, boards should have flexibility to conduct self-assessments in the manner they deem most appropriate with whatever documentation they feel is appropriate. As such, if retained, the Board Proposal's description of the particular elements a board's assessment should cover should be modified to indicate that these are illustrative and not dispositive. The Board Proposal, for example, should not implicitly or explicitly favor written questionnaires. In practice, many boards conduct oral, rather than written, self-assessments, and these boards should not be required to change their practices as a result of the guidance.

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The Society appreciates the opportunity to comment on the Board Proposal and would be glad to discuss our comments further or respond to any questions you may have.

Sincerely,

James G. Martin, Esq.
SVP & General Counsel
Society for Corporate Governance

[1] Governor Jerome H. Powell, *The Role of Boards at Large Financial Firms*, Large Bank Directors Conference in Chicago, Illinois, August 30, 2017.

[2] Attribute A states that "[s]ignificant policies, programs and plans include the firm's capital plan, recovery and resolution plans, enterprise-wide risk management policies, liquidity risk management policies, compliance risk management program, and incentive compensation and performance management programs."

[3] This language should also be clarified to refer to the risks that it is appropriate for the firm to take. The current language appears to refer to the risks the board takes.

[4] Similarly, existing guidance frequently requires that the board "ensure" a particular result. These requirements should be revised to reflect the board's oversight role in connection with the Federal Reserve's review of board requirements.

[5] The Board Proposal acknowledges that the proposal for the board to approve chief risk officer and chief audit executive succession plans may be broader than other statutory and regulatory authorities, noting as an example the requirement only for formalized CEO succession plans under the New York Stock Exchange Listed Company Manual, Section 303A.09, and further states that "[s]uccession plans for other members of senior management, such as the chief financial officer (CFO), may be warranted." The statement that approval "may be warranted" may set up an expectation that such plans must be approved and presents interpretive issues for the board as to which members of management are expected to be covered.

[6] We note in this regard that indicating self-assessments may be "optional" in any final rule could effectively make this a requirement.