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The Goldman Sachs Group, Inc.

December 29, 2017

Goldman Sachs

<u>Via E-mail</u>

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

## Re: <u>Proposed Guidance on Supervisory Expectations for Boards of</u> <u>Directors – Docket No. OP-1570</u>

Ladies and Gentleman:

I appreciate the opportunity to comment on the Proposed Guidance on Supervisory Expectations for Boards of Directors (the "<u>Proposed Guidance</u>") issued by the Board of Governors of the Federal Reserve System (the "<u>Federal Reserve</u>"), which would refocus the Federal Reserve's supervisory expectations of boards of directors of banking organizations on a board's core responsibilities. I am submitting this letter in my capacity, and based upon my experience, as Lead Director of The Goldman Sachs Group, Inc.

First, I would like to express my support for the Proposed Guidance and commend the Federal Reserve for recognizing the distinct role of the board of directors from that of senior management. The preamble to the Proposed Guidance acknowledges that supervisory expectations for boards of directors and senior management have led to the conflation of these roles and that boards have increasingly needed to devote significant time to satisfying supervisory expectations that are not related to a board's core responsibilities. I agree that greater clarity regarding these supervisory expectations could improve corporate governance and increase efficiency while still resulting in accountable and effective boards. I believe that refocusing boards of directors on their core responsibilities, and away from routine matters that may be appropriately addressed by management, can achieve these intended benefits of the Proposed Guidance.

The Proposed Guidance is a significant step in the right direction, and I appreciate that the Federal Reserve is soliciting comments on where the text of the

Proposed Guidance presents opportunities for improvement. While I strongly support the intention behind and underlying premise of the Proposed Guidance, I would respectfully note that, as written, the Proposed Guidance could be read as implicitly creating various prescriptive and granular "check the box" requirements for a board to be considered effective, which would be inconsistent with the Federal Reserve's stated intention of avoiding "process-oriented supervisory expectations that do not directly relate to the board's core responsibilities."

To illustrate this issue, I would highlight the following examples from the Proposed Guidance. First:

An effective board engages in robust and active inquiry into, among other things, drivers, indicators, and trends related to current and emerging risks; adherence to the board-approved strategy and risk tolerance for relevant lines of business; material or persistent deficiencies in risk management and control practices; and the development and implementation of performance management and compensation programs that encourage prudent risk-taking behaviors and business practices, which emphasize the importance of compliance with laws and regulations, including consumer protection.

This example provides granular detail (without a clear materiality qualifier) regarding the various matters into which a board should "engage in robust and active inquiry," which seems to extend well beyond the attribute that this example supports (which is that the board should "hold senior management accountable"). In fact, the one enumerated item that contains a reference to materiality - "material *or persistent* deficiencies in risk management and control practices" (emphasis added) - would appear to require that boards inquire into immaterial matters if they are recurring. While I acknowledge that I am focused on the precise language set forth in the Proposed Guidance, it is important that boards, as well as on-site supervisors, understand exactly what the Proposed Guidance requires. To this end, it is unclear whether boards must demonstrate to examiners that they have sufficiently inquired into each of these matters (whether or not material) in order to be deemed effective, which could lead boards to take a "check the box" approach of making and documenting these inquiries, regardless of whether these actions would be consistent with the board's core responsibilities.

Another example could also be subject to misinterpretation:

Directors of an effective board take an active role in setting board meeting agendas such that the content, organization, and time allocated to each topic -2-

allows the board to discuss strategic tradeoffs and to make sound, well-informed decisions.

This example could be interpreted to suggest that all directors must "take an active role" in setting meeting agendas, which also seems to extend well beyond the attribute it supports (which is that the board should "actively manage information flow and board discussions"). Given the common practice of empowering independent chairmen, lead directors and committee chairs to work with management to determine board and committee agendas, it is unclear whether this example would encourage boards to instead, or also, engage in a rote "check the box" exercise involving all directors to demonstrate compliance. Such an exercise would be an inappropriate use of board resources and would detract from the time available to engage in more meaningful oversight.

While it is clear that there are many relevant and significant considerations for boards embedded within the illustrative lists and examples in the Proposed Guidance, not all of the elements detailed therein will be relevant in every situation and across all boards. This is important because it is not clear from the Proposed Guidance what the consequences would be if a board does not follow these examples *precisely*, including whether it could affect a firm's supervisory ratings.

The Proposed Guidance should explicitly state that the examples that are used to describe the five attributes of an effective board are not meant to be prescriptive or impose new requirements on boards, but rather are meant to be merely illustrative of matters that may be considered. Without such a statement, there is a serious risk that the Proposed Guidance will lead a board to feel that it must take actions that it would not otherwise deem necessary in an effort to demonstrate to on-site supervisors that the board is effective and has complied with the examples.

As a related principle, boards should have "flexibility to meet [the Federal Reserve's expectations] in a manner that works for their particular boards," as Federal Reserve Governor Jerome H. Powell recently noted in his remarks on the Proposed Guidance.<sup>1</sup> It is important that the Proposed Guidance acknowledge that there is no "one size fits all" approach to corporate governance.

In addition, any examples used in the Proposed Guidance (and in the Federal Reserve's regulations and other guidance) should be aligned with the oversight

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

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role of the board. In the Proposed Guidance, for example, statements that an effective board "establishes" a firm's strategy should be revised to provide that a board should provide "oversight, guidance and input" on senior management's strategic plan. As another example, the statement that "an effective board… sets the types and levels of risk it is willing to take" should be revised both to clarify that "risk it is willing to take" refers to risk of the firm, and not that of the board, and to provide that the board should oversee, rather than set, these items. As a general matter, the board's appropriate role is not to "establish," "set" or "develop" a firm's plans, policies or procedures or to "ensure" or "make certain" that certain outcomes are achieved. These responsibilities would be inconsistent with the board's oversight role. Respectfully, I suggest that the Federal Reserve revise its requirements accordingly in connection with its comprehensive review of all existing supervisory expectations and regulatory requirements relating to boards of directors, as announced in the second part of the Proposed Guidance.

Finally, to help further define the board's oversight role and allow it the time to focus on its core responsibilities, it would be helpful if the Federal Reserve recognized that requirements for board review or approval should be subject to an overarching materiality standard, which banking organizations necessarily must exercise judgment in applying. Relatedly, detailed requirements for board review and/or approval of policies and procedures that relate to particular compliance, treasury or business activities should be eliminated, with the understanding that any particular organization must determine which policies or procedures may be sufficiently material for that organization to warrant review and/or approval at the board level. Where a material plan (e.g., capital plan, resolution plan, risk appetite statement) or program (e.g., the Volcker Rule compliance program) may appropriately be required to be approved by the board. the Federal Reserve should expressly state that such approval is in the context of the board's oversight role (i.e., that the board's role is to oversee and approve its material elements, and not to discuss or approve its granular details). In this regard, the Federal Reserve should clarify that summaries prepared by management may be relied upon by the board, particularly if the detail of a plan or program is voluminous or granular and technical.

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I appreciate your consideration of my comments and would like to reiterate my support of the Federal Reserve's efforts to refocus supervisory expectations of boards of directors on core responsibilities. I would be pleased to discuss these comments and suggestions with you in more detail and to provide additional information that may be helpful.

Sincerely,

Adebayo O. Ogunlesi Lead Director The Goldman Sachs Group, Inc.