THE RISK MANAGEMENT ASSOCIATION

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VIA E-MAIL

October 6, 2017

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

Re: Docket ID OP-1570, "Proposed Guidance on Supervisory Expectations for Boards of Directors" (the "Proposed Guidance")

Ladies and Gentlemen:

This letter is submitted by The Risk Management Association ("RMA" or the "Association") in respect of the Proposed Guidance issued by the Board of Governors on August 3, 2017, which would establish principles regarding effective boards of directors ("boards").

RMA is concerned that bank boards are increasingly focused on details concerning the daily activities of banks. The overburdening of bank directors with responsibilities that are insignificant or that are better delegated to management is a serious public policy issue. Bank directors need to focus on the important issues facing their banks to meet their fundamental duties of care and loyalty. While experts may serve on board Audit and Risk Committees, most directors are not full-time bank officers or employees and in most cases, they are not professional bankers.

RMA supports the view espoused by Federal Reserve Board Governor Powell in his April 20, 2017, speech at The Global Finance Forum, where he stated:

> Some aspects of the new regulatory program are proving unnecessarily burdensome and should be better tailored to meet our objectives. Some provisions may not be needed at all given the broad scope of what we have put in place. I support adjustments designed to enhance the efficiency and effectiveness of regulation without sacrificing safety and soundness or undermining macroprudential goals.
>
> One example where some adjustments are warranted is our supervisory relationship with the boards of directors of banking firms. After the crisis, there was a broad increase in supervisory expectations for these boards. But it is important to acknowledge that the board's role is one of oversight, not management. We need to

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> ensure that directors are not distracted from conducting their key functions by an overly detailed checklist of supervisory process requirements. Rather, boards of directors need to be able to focus on setting the overall strategic direction of the firm, while overseeing and holding senior management accountable for operating the business profitably, but also safely, soundly, and in compliance with applicable laws.[1]

In the United States, corporate governance traditionally has been carefully balanced between the board of directors which is charged with policy formulation and oversight and senior management which is charged with execution of policy and strategy and the day-to-day operations of the business. In the wake of Sarbanes-Oxley and the Dodd-Frank Act, the traditional system of corporate governance has undertaken a fundamental shift as the regulatory agencies have shifted responsibilities to the board that had formerly been the province of management. RMA supports the Proposed Guidance because it represents a shift back to traditional corporate governance in terms of the role of the board. With the plethora of laws and regulations pertaining to banks, as Governor Powell noted, requiring the board to ensure compliance with more than 800 legislative and regulatory provisions[2] is a Sisyphean task. Rather the board should have oversight of compliance of certain critical laws or policies, as identified by the board, with senior management reporting on such laws and policies on a regular basis.

Introduction

RMA is a 501(c)(6) not for-profit, member-driven professional association whose sole purpose is to advance the use of sound risk management principles in the financial services industry. RMA helps its members use sound risk management principles to improve institutional performance and financial stability and enhance the risk competency of individuals through information, education, peer-sharing and networking. RMA has 2,500 institutional members that include banks of all sizes as well as nonbank financial institutions. They are represented in the Association by more than 18,000 risk management professionals who are chapter members in financial centers throughout North America, Europe, and Asia/Pacific.

This letter is divided into two Parts:

[1] Speech by Governor Jerome H. Powell at The Global Finance Forum, Washington, DC (April 20, 2017). https://www.federalreserve.gov/newsevents/speech/powell20170420a.htm

[2] The American Association of Bank Directors has identified "more than 800 federal banking laws, regulations and regulatory 'guidance' that create obligations on bank boards of directors and their committees." *See http://aabd.org/heavy-regulatory-burdens-bank-directors-getting-heavier/*

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- Part I contains RMA's responses to certain of the questions posed by the Federal Reserve in the Proposed Guidance, namely, Question 1 (regarding the application of the proposed BE guidance to boards of the U.S. intermediate holding companies of foreign banking organizations and state member banks); Question 2 (regarding other attributes of effective boards); Question 3 (whether boards should be required to perform a self-assessment of their effectiveness and provide the results to the Federal Reserve); Question 5 (regarding the communication of supervisory findings); and Question 6 (regarding supervisory expectations for boards not included in Table A of the Proposed Guidance).

- Part II sets forth other commentary directed at certain provisions of the Proposed Guidance.

One of the most important components of RMA's mission is to provide independent analysis on matters pertaining to risk and capital regulation. In this regard, the comments contained herein are informed by subject matter experts from member institutions of the Association, but are not attributable to any single institution or group of institutions, some of whom may file their own comment letters.

PART I -- Responses to Certain Questions Presented

Question 1. The Federal Reserve is considering applying the proposed Board Effectiveness guidance to U.S. intermediate holding companies of foreign banking organizations. How should the Proposed 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?

> **RESPONSE.** RMA submits that clarifying supervisory expectations for U.S. intermediate holding companies ("IHCs") of foreign banking organizations, whether with respect to the Proposed Guidance or any future guidance, should be undertaken in a manner consistent with the supervisory expectations of institutions with $50 billion or more in assets and systemically important nonbank financial companies to whom the Proposed Guidance or such future guidance would apply so that a competitive advantage is not conferred upon the IHC of any such foreign banking organization.

Question 2. What other attributes of effective boards should the Board assess?

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RESPONSE. RMA agrees that the five attributes of effective boards[3] set forth in the Proposed Guidance are sufficient to support safety and soundness and provide a framework for the Federal Reserve to assess an institution's board. Adding additional attributes or other criteria under which an institution's board would be assessed could result in additional regulatory burden for a board, thereby resulting in the unintended consequence of dilution of the board's focus on its core responsibilities.

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?

RESPONSE. Whether a bank's board undertakes a self-assessment should be a matter left to the discretion of the individual board.

Requiring a periodic self-assessment, particularly where the attributes to be assessed are process-based, would have several unintended consequences. For example, a self-assessment would tend to become a regulatory process to be managed, particularly if the results of the self-assessment were to be communicated to the regulatory agencies. Developing, implementing and managing that process would, in turn, add to the burden of boards and would run the risk of the regulatory agencies defining so-called "best practices" to be followed by boards regardless of the size, scale or complexity of the bank or the skills and experience of the board members. Finally, because the five attributes relate wholly to process not to outcomes, a self-assessment tool – whether or not shared with the regulators – would become a process in itself, the management of which could lead to board ineffectiveness, the very thing that the Proposed Guidance seeks to avoid.

In addition, requiring a periodic self-assessment is not necessary for several reasons. First, the New York Stock Exchange ("NYSE") Rules set forth expected qualifications of directors[4] and mandate that boards of listed companies undertake an annual self-assessment to determine whether the board and its underlying committees are functioning effectively.[5] RMA would note that most bank holding companies with assets in excess of $50 billion are listed on the

[3] "Set clear, aligned, and consistent direction regarding the firm's strategy and risk tolerance; actively manage information flow and board discussions; hold senior management accountable; support the independence and stature of independent risk management and internal audit; and maintain a capable board composition and governance structure."

[4] For example, NYSE Rule 303A.09 states that certain independence requirements must be met and provides that "companies may also address other substantive qualification requirements, including policies limiting the number of boards on which a director may sit, and director tenure, retirement and succession."

[5] NYSE Rule 303A.09 states that "the board should conduct a self-evaluation at least annually to determine whether it and its committees are functioning effectively."

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NYSE, and, are therefore, undertaking the NYSE self-assessment. In addition, boards of other non-NYSE listed companies are also actively undertaking self-assessments as a matter of good corporate governance. Moreover, institutional shareholders recognize the value of self-assessments, and, accordingly, maintain expectations that boards conduct thorough self-assessments and make disclosures regarding the self-assessment process and results in annual proxy materials.

However, in the event that the Federal Reserve would require the performance of a board effectiveness self-assessment, RMA would offer the following additional comments. The requirement for any self-assessment should be principles-based, not prescriptive, and should permit a board to tailor its self-assessment based on the size, scale and complexity of the institution and the skills and experience of the directors, individually and taken as a whole. RMA would note that any self-assessment be permitted to be designed by a board to take into account the NYSE rules and that board's use of committees and their attendant structures and composition.

In short, RMA believes that it is best left to the reasonable discretion of each institution's board to determine its approach to self-assessment, because its approach needs to fit the unique business, risk culture and risk appetite of the institution, taking into account its respective size, scale, and complexity in order to ensure that the members of its board are fully engaged in their core responsibilities.

RMA is concerned that the mandated use of a self-assessment and any requirement that the results thereof be made available to the regulators could lead to convergence of board practices. To the extent that the Federal Reserve recognizes some signs of convergence on certain aspects of board practices, RMA believes that there should not be an expectation that all aspects of board practice will or should eventually converge. Accordingly, the Federal Reserve should apply a principles-based approach, as opposed to a prescriptive one, to ensure that banks have the freedom and flexibility to manage their corporate affairs independently in order to foster innovation and to respond to evolving risks. In short, the supervisory community does not want to inadvertently thwart ingenuity and problem solving brought to bear by diverse industry participants through a prescriptive, by-rote approach to the promulgation of standards pertaining to Board effectiveness.

To the extent that the Federal Reserve would require the board self-assessment to be submitted to it, a thorny issue is raised that would need to be reconciled, namely, whether the conduct of the self-assessment and its results become Confidential Supervisory Information, and, if so, whether such an outcome can be reconciled with the increased disclosure requests

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by institutional shareholders regarding the conduct and outcome of the self-assessment process.

Question 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?

RESPONSE. RMA notes that the role of the board is one of oversight. Accordingly, RMA respectfully suggests that a board, in the proper exercise of its oversight authority, should not establish policies instructing management how to respond to MRAs and MRIAs. RMA believes that the proposed guidance on the communication of supervisory findings is sufficiently clear with respect to the division of responsibilities between the board and senior management. By limiting the communication of MRIAs and MRAs to the board only in instances where the board needs to address its own corporate governance responsibilities or where senior management fails to take appropriate remedial action is consistent with the board having an oversight role, as opposed to an active role in the management of the affairs of the bank.

Question 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?

RESPONSE. In order to assure consistency of the Federal Reserve's expectations of bank boards, RMA would respectfully suggest that all SR letters -- such as SR 11-7, "Guidance on Model Risk Management" -- which make reference to the roles and responsibilities of the board be revised such that the Proposed Guidance becomes the appropriate standard.

PART II – Additional Commentary

The fourth attribute of an effective board states that an effective risk committee directs "the appropriate inclusion of representatives of the independent risk management function on senior management-level committees" and "can effect changes that align with the firm's strategy …" RMA notes that risk committees generally do not specify which members of the independent risk function should serve on senior management-level committees. This would appear to be an instance where the line between the board and senior management would be blurred. Similarly, the empowering the risk committee to "effect change" would appear to be empowering the risk committee to take action rather than exercise oversight. Accordingly, RMA would respectfully suggest that these powers of the risk committee be deleted from the final version of the Proposed Guidance.

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RMA is concerned that boards are (i) facing increasing documentation burdens and (ii) increasing their scope or mandate beyond their advisory and oversight functions into actual management of the Bank. RMA has been concerned that post-crisis regulation and supervisory expectations have, in effect, codified a shift in tone and expectation regarding the role of the board of directors, namely that the board appears to be required to function not as a board in the traditional sense, but rather, as another layer of management.

RMA notes that the American Association of Board Directors has identified over 800 legislative and regulatory provisions that have accumulated over many decades that impact the responsibilities of bank directors. We submit that the ever-increasing regulatory burden creates a significant distraction from board time necessary for effective risk oversight and other essential board responsibilities. The increasing threat of regulatory and personal liability is forcing bank boards to become "compliance" boards where attention must be focused on satisfying laws, regulations, and regulatory guidance that pertain to duties that are properly the function of day-to-day management.

There is virtually no recognition in the federal banking laws, regulation and guidance that it is prudent and consistent with a board's fiduciary duties for the board to rely reasonably on management and advisors. Yet this is the foundation of modern American corporate law. Every state recognizes either in statute or case law that corporate board members may reasonably rely on their management or on their opinions, information, reports and statements.

The post-crisis requirement that boards become engaged in an increasing amount of day-to-day activities that are properly in the domain and expertise of management has resulted in the unintended consequence of diluting the effectiveness of board governance. It will become increasingly difficult for boards to (a) recruit and retain qualified directors in the face of increasing regulatory burden and (b) provide effective oversight if boards are engaged as decision-makers or are involved in the operations of the bank.

In discharging their risk oversight function, boards should monitor bank performance against risk appetite and other metrics established pursuant to key policies approved by the board or its committees. Bank boards should be receiving high level information and key risks of concern in the context of informative and actionable reports from management. However, it is management which is responsible for managing risk, not the board which is charged with risk oversight.

RMA is supportive of the Federal Reserve's determination that the Proposed Guidance is necessary to refocus boards on their core responsibilities. RMA appreciates this

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opportunity to comment on the Proposed Guidance and requests that the Federal Reserve take a principles-based, as opposed to a prescriptive, approach to the supervisory oversight of the effectiveness of boards. RMA believes that the Federal Reserve should focus attention on the "outcome" of board practices rather than attempting to harmonize the procedures followed by the boards of banks subject to the Proposed Guidance so that compliance with the final version of the Proposed Guidance does not simply result in a compliance exercise. Finally, RMA respectfully suggests that it is important for the prudential regulators to harmonize their respective expectations of the board to ensure consistency regarding the board's mandate, which should be to discharge its oversight functions.

Should there be any questions concerning the comments reflected above, kindly contact Edward J. DeMarco, Jr., General Counsel and Director of Regulatory Relations at (215) 446-4052 or edemarco@rmahg.org.

Very truly yours,

Edward J. DeMarco, Jr.,
General Counsel & Director of Regulatory Relations