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February 15, 2018

Via Electronic Mail

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

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

Ladies and Gentlemen:

The Clearing House Association L.L.C., The Clearing House Payments Company L.L.C., the American Association of Bank Directors and the Securities Industry and Financial Markets Association appreciate the opportunity to comment on the Board of Governors of the Federal Reserve System's proposed guidance on its supervisory expectations for boards of directors.[1] The proposal advances two fundamental and important objectives that we wholly endorse. First, it appropriately recognizes, and places emphasis on maintaining, the crucial distinction between the board's duty of oversight and management's responsibility for the operations of the banking organization. Second, it strives to eliminate unnecessary regulatory requirements for board approval, action or review so that the board can focus on oversight of the execution of the company's strategy and its other principal responsibilities. By furthering these goals, the proposal helps to direct board focus toward fundamental safety and soundness issues and performance of the board's oversight function. And the proposal helps protect against the risk

[1] Federal Reserve System, *Proposed Guidance on Supervisory Expectations for Boards of Directors*, 82 Fed. Reg. 37219 (Aug. 9, 2017).

that, when requirements are imposed in a prescriptive way or include ambiguous language that could be interpreted as recasting this separation, they make it challenging for boards to concentrate on satisfying their larger role of focusing on strategy and emerging risks and trends.[2]

In light of these crucial goals in supporting effective board governance, which we share, we offer in this letter recommendations designed to strengthen and clarify how they are reflected in the specific details of the proposal. Three of these are paramount.

First, the final guidance should more clearly acknowledge and emphasize that it establishes supervisory expectations for boards that are based on principles, and not "one-size-fits-all" standards. This is particularly important because, although perhaps not intentional, several of the examples used to describe the five attributes of effective boards in the proposal appear specific and prescriptive, and thus rigid rather than principles-based. These potential problems can and should be addressed by removing or qualifying any illustrative lists or examples contained in the final guidance that might be read to create "checklist" or "check-the-box" requirements that examiners might "test" boards against, which we do not believe was the Federal Reserve's intention.[3]

Second, the specific language of the guidance should be revised in favor of terms that are unambiguously consistent with the board's oversight role (*e.g.*, the board should "oversee," "review" or, where appropriate, "approve," rather than "establish" or "set" policies, strategies, appetites, plans or procedures), and unambiguously distinct from the role of management. Similarly, the final guidance should explicitly clarify that "active engagement" by the board does not require or contemplate directors being engaged in the day-to-day affairs of the banking organization, and that boards can and should effectively fulfill their oversight role through

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2 For a detailed analysis and description of the importance of these goals in bank governance, *see* Paul Harris and Gregg Rozansky, *The Transforming Role of the Bank Board*, 2017 Q3 Banking Perspectives—Rethinking Regulation and Supervision, available at https://www.theclearinghouse.org/research/banking-perspectives/2017/2017-q3-banking-perspectives/bank-board-responsibilities.

See also The Clearing House, *The Role of the Board of Directors in Promoting Effective Governance and Safety and Soundness for Large U.S. Banking Organizations* (May 2016), at 6 (the "TCH 2016 Directors Report"), available at https://www.theclearinghouse.org/sitecore/content/tch/home/issues/articles/2016/05/20160505-tch-publishes-the-role-of-the-board-of-directors-report. The TCH 2016 Directors Report notes that the distinction between the roles of the board and management "is particularly critical in the context of the board of directors of a large U.S. banking organization as it navigates a confluence of fiduciary responsibilities under state law, requirements under federal banking law, as well as supervisory expectations and mandates of regulators (which typically include a number of U.S. and non-U.S. regulatory bodies for a large banking organization operating in multiple jurisdictions)."

3 Chairman Powell (then Governor Powell) explained that the proposal "will move to a principles-based approach. . . . 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." Governor Jerome H. Powell, *The Role of Boards at Large Financial Firms*, Speech at the Large Bank Directors Conference, Chicago, Illinois (Aug. 30, 2017). A transcript of the speech is available at https://www.federalreserve.gov/newsevents/speech/powell20170830a.htm.

various means depending on what different circumstances and different institutions require.[4] It also should be broadly recognized that a board may delegate its functions to a board committee in the appropriate exercise of the board's oversight duties.[5]

Third, the discussion of board self-assessments should be removed in light of the significant and counterproductive risks posed by specific expectations in this area—most prominently, the risks that firms will be expected to share the results of such assessments with supervisors, even if such sharing is technically deemed "voluntary." Such expectations would likely have a chilling effect on a board's self-assessment process and results because directors may (quite reasonably) be less candid if they are concerned that the results of the self-assessment could be used to support adverse supervisory findings, used against them in litigation, or otherwise taken out of context. As such, we do not believe that the results of self-assessments should be used to inform supervisory findings. And as discussed in greater detail below, there are other more appropriate means and sources of information on which examiners can rely to assess board effectiveness.

Each of these three overarching concerns is described in more detail in Part II below. In addition, Part III of this letter provides concrete and specific recommendations to clarify and strengthen the five attributes of effective boards identified in the proposal, again in furtherance of the underlying goals of the purposes.

We wish to make clear that, in identifying these concerns and making recommendations, we are not advocating for lower or less stringent expectations for boards. As Federal Reserve Chairman Jerome H. Powell (then Governor Powell) has rightly noted, the proposal is not intended to, and in practice should not, "lower the bar" for directors but instead to promote effective governance and safety and soundness by enabling directors to focus on their core responsibilities rather than the specifics of numerous technical supervisory expectations or routine matters.[6] The recommendations we offer in this comment letter are intended to be in furtherance of that goal.

Finally, the proposal raises three specific issues that we believe must be addressed. First, as the Federal Reserve reviews various regulations (including Regulation YY) and interagency guidance on related topics and finalizes the proposed guidance, it will be important that supervisors take a measured approach in the examination context, recognizing the forthcoming changes to Federal Reserve expectations reflected in the proposal. Second, we strongly endorse the proposed guidance on the communication of supervisory findings, which would supersede SR letter 13-13/CA letter 13-10. And third, the Federal Reserve should issue a proposal specific to boards of directors of intermediate holding companies ("IHCs") of foreign banking

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4 *See* TCH 2016 Directors Report, at 15 ("The board's approach to, and level of engagement on, particular issues and proposals will vary depending upon a number of considerations such as the criticality of the matter at issue and the comprehensiveness of prior reviews and analysis.").

5 References in this letter to "committee" also refer to any "subcommittee" in the context of a board's ability to delegate.

6 *See* Powell, *supra* note 3.

organizations that is based on the same principles of distinguishing board oversight from management and refocusing board attention on core responsibilities, but also takes into account the differences in the role of the IHC and its board from a U.S. top-tier bank holding company and its board as well as the variation in governance approaches among IHCs.

I. Executive Summary

- The final guidance should more clearly acknowledge and emphasize that the Federal Reserve's expectations for board effectiveness and corporate governance are based on principles, and not "one-size-fits-all" standards.

- The final guidance should more clearly distinguish the role of the board from the role of management, and clearly and consistently describe the role of the board as one of oversight.

- The proposal's discussion of board self-assessments should be removed from the proposal, and the results of self-assessments should not be used to inform supervisory findings.

- The proposal's introductory discussion of "Attributes of Effective Boards of Directors" should be revised to provide a clear description of core board functions.

- The proposal's discussion of the first attribute (Set Clear, Aligned, and Consistent Direction) should be revised to more clearly distinguish the role of the board in overseeing strategy from management's role in developing and executing it.

- The proposal's discussion of the second attribute (Actively Manage Information Flow and Board Discussion) should clarify that the "right" methodology for boards to use in obtaining and evaluating information depends on numerous factors and varies for each board.

- The proposal's discussion of the third attribute (Hold Senior Management Accountable) should be more consistent with the board's oversight role and should clarify that the board's engagement with senior management need not be adversarial.

- The proposal's discussion of the fourth attribute (Support the Independence and Stature of Independent Risk Management and Internal Audit) should be revised to better clarify the distinctions between the roles of the board and management and acknowledge that boards generally have flexibility to determine where particular elements of risk oversight are centered.

- The proposal's discussion of the fifth attribute (Maintain a Capable Board Composition and Governance Structure) should confirm that there is no "one-size-fits-all" standard for a board's composition, how the board conducts its meetings or the size and number of board committees.

- The Federal Reserve should work quickly toward completing its review of existing expectations of boards and, in the interim, examiners should take a measured approach, recognizing the forthcoming changes to these expectations.

- We strongly endorse the proposed guidance on communication of supervisory findings.

- The Federal Reserve should issue a proposal specific to boards of directors of IHCs that is based on the same principles of distinguishing board oversight from management and refocusing board attention on core responsibilities, but also takes into account the differences in the role of the IHC and its board from a U.S. top-tier bank holding company and its board as well as the variation in governance approaches among IHCs.

II. Overarching Concerns with the Proposal

A. The final guidance should more clearly acknowledge and emphasize that the Federal Reserve's expectations for board effectiveness and corporate governance are based on principles, and not "one-size-fits-all" standards.

The preamble to the proposal quite rightly notes that the establishment and application of standardized expectations for boards of directors is inappropriate, as such an approach fails to take into account banking organizations' particular activities, risk profiles and complexity,[7] and thereby prevents a board from achieving maximum effectiveness. We are concerned, however, that certain other statements and details of the proposal might be interpreted and applied by examiners in practice in a manner that is inconsistent with that basic principle. Thus, we believe it is very important that the Federal Reserve acknowledge in the final guidance that it will not employ, and the final guidance should not be construed as, a "one-size-fits-all" approach to corporate governance. In particular, we are concerned that certain of the examples provided in the proposal could be read to provide standardized, prescriptive lists that examiners would "test" boards against. The practical consequences of such a result would be significant and negative—if directors believe that they must conduct their oversight based on regulatory examples and a "check the box" approach, rather than on the basis of their own evaluation of the needs of the company, the directors' effectiveness will be compromised.

Accordingly, the proposal should be revised to state expressly that specific examples in the guidance are for illustrative purposes only, and may not be appropriate for or applicable to all institutions or in every circumstance. In addition, the final guidance should clearly provide that examiners should evaluate a board's effectiveness by seeking to understand how the attributes identified in the guidance are applied in the context of the particular institution, and <u>not</u> by applying a checklist approach to board practices and procedures. We think that this clarity is particularly important given that the board effectiveness guidance is expected to be used in

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7 82 Fed. Reg. 37219, 37219–37220.

connection with supervisors' assessments of board effectiveness under the proposed rating system for large financial institutions.[8]

As a specific example that illustrates this issue, the proposal identifies a list of "significant" policies, programs and plans[9] that must be assessed by the board for consistency with the firm's strategy, risk tolerance[10] and risk management capacity. The proposal should be revised to provide that these "may be" the relevant policies, programs and plans, and that firms are best positioned to determine both the appropriate universe of policies, programs and plans (and/or material aspects of such policies, programs and plans) to be considered by the board or one of its committees and the items that should be considered in connection with that review.

B. The final guidance should more clearly distinguish the role of the board from the role of management, and clearly and consistently describe the role of the board as one of oversight.

Although we understand the intention of the proposal is to clearly distinguish the roles of boards and management, we are concerned that certain terminology used in the proposal may undermine that goal. In particular, references to the board's role as "establishing" or "setting" should be rephrased in terms of "oversight," "review" and/or, where appropriate, "approval." For example, in the introduction describing the attributes of effective boards of directors, the proposal states:

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8 Federal Reserve System, *Large Financial Institution Rating System; Regulations K and LL*, 82 Fed. Reg. 39049 (Aug. 17, 2017).

9 The proposal 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."

10 It is our understanding that the Federal Reserve is using the term "risk tolerance" interchangeably with the term "risk appetite," as used in SR 12-17 and other supervisory communications. *See* Federal Reserve System, Division of Banking Supervision and Regulation, *Consolidated Supervision Framework for Large Financial Institutions*, SR Letter 12-17 (Dec. 17, 2012). In its proposed guidance on effective senior management, the Federal Reserve specifically requested comment on whether the industry uses those two terms interchangeably and what confusion, if any, would be created by using the term "risk tolerance" instead of "risk appetite" in the proposed guidance. Federal Reserve System, Proposed Supervisory Guidance, 83 Fed. Reg. 1351, 1355 (January 11, 2018). We confirm that the two terms are used interchangeably by the industry. Nevertheless, to eliminate any possibility of confusion, we request the Federal Reserve to either use the term "risk appetite" or confirm that it is using the two terms interchangeably.

> A board is most effective when directors focus on *establishing* a firm-wide corporate strategy and *setting* the types and levels of risk it[11] is willing to take (also referred to as risk tolerance), *making certain* that senior management effectively carries out that strategy within the established risk tolerances, and holding management accountable for its actions, including effective risk management and compliance.[12]

This and similar statements in the proposal should be revised to refer to the board's role of oversight and, where appropriate, approval, rather than "establishing" or "setting." It is the role of management, and not the board, to set or establish policies, plans or procedures. In addition, the phrase "making certain that senior management effectively carries out" strategy could lead boards to believe they are expected to manage, rather than oversee, management (as well as creating an inappropriate standard). To be more consistent with the board's oversight role, these and similar statements in the final guidance should unambiguously make clear that the board is expected to oversee and evaluate the effectiveness of senior management in carrying out the firm-wide corporate strategy.

For similar reasons, and as a general matter, the final guidance should recognize and clarify that a board's time is best spent on matters that are material to the organization. For example, in describing the first attribute, references to business lines and growth strategies (including plans to enter into a "new jurisdiction") that warrant board consideration and assessment should be limited to those that are material to the organization. Similarly, in describing the third attribute, the drivers, indicators and trends into which an effective board inquires should be limited to those that are material to the organization.

Additional examples from the proposal that should be revised to better reflect the oversight role of the board are highlighted in our discussion of each of the five attributes in Part III below.

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[11] The reference to the "risk *it* is willing to take" (emphasis added) could be read to refer to risk-taking by the board, and should be revised to refer to the risks that it is appropriate for the firm to take. A similar formulation is used in the first paragraph under the first attribute as well ("an effective board of directors . . . sets the types and levels of risk it is willing to take.").

[12] 82 Fed. Reg. 37219, 37224 (emphasis added).

C. The proposal's discussion of board self-assessments should be removed from the proposal, and the results of self-assessments should not be used to inform supervisory findings.

We strongly recommend removal of the discussion related to board self-assessments from the proposal, and especially any notion that the results of such assessments are to be shared with regulators.[13]

Boards already conduct and derive significant value from self-evaluations (*e.g.*, as required by New York Stock Exchange rules for its listed companies)[14] in connection with shareholder expectations and because they determined that these evaluations are a sound corporate governance practice. Self-assessment practices appropriately vary among the firms as they are intended to serve as a useful tool for individual boards themselves.[15] Requiring, or expecting (even if only implicitly), a board's self-assessment to take a particular form or cover a prescribed set of issues or to be used for supervisory evaluations would be contrary to the objectives of a self-assessment (*i.e.*, a candid assessment of how the board sees itself and areas for potential improvement), and may create another "check-the-box" requirement for boards. As the TCH Guiding Principles state, "ultimately, the particular circumstances of the board and the organization should inform the focus, form and content of board evaluations."[16]

An expectation that self-assessment results should be provided to supervisors could inhibit the particular forms of self-assessment currently employed by firms and lead to a "one-

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13 *See* 82 Fed. Reg. 37219, 37224 (a board of directors also may provide to supervisors a self-assessment of its effectiveness, for example, relative to the five attributes, which the Federal Reserve would take into consideration in its evaluation); 82 Fed. Reg. 37219, 37223 (seeking input on whether boards of firms subject to the board effectiveness guidance should be required to perform self-assessments and provide the results of those self-assessments to the Federal Reserve).

14 NYSE Listed Company Manual, § 303A.09 (requiring boards to conduct a self-evaluation at least annually to determine whether it and its committees are functioning effectively). Although NASDAQ does not have a similar requirement, many companies listed on NASDAQ have adopted a board self-evaluation process as a matter of good corporate governance.

15 In our experience, different approaches are taken by banks to foster an appropriate level of candor and self-reflection. For example, some firms may solicit feedback in written form, and others may provide a discussion guide or questionnaires to facilitate one-on-one discussion and feedback with a chair or lead director. Some may provide a high-level summary of results in board materials, and others may have the chair or lead director lead a discussion among board members in executive session to discuss the results. It is critical that the self-assessment process remain flexible so that the process itself, areas of focus and the like can change over time depending upon the relevant facts and circumstances.

16 The Clearing House, *Guiding Principles for Enhancing U.S. Banking Organization Corporate Governance* (2015), at 34 (the "TCH Guiding Principles").

size-fits-all" approach to satisfy the expectation.[17] In addition, it could have a chilling effect on the responses of directors (*i.e.*, board members may not be as open and frank as they might otherwise be) if there were concerns that the self-assessment results would be used as a basis for supervisors' evaluation of the board's effectiveness or could otherwise be taken out of context or end up in the public domain notwithstanding efforts to protect the information from disclosure. For these reasons, there should not be any suggestion in the final guidance that self-assessment results should be shared with supervisors as a basis for supervisory ratings or otherwise.

We recognize that the proposal describes the provision of self-assessments to supervisors as voluntary. However, even this language could create a negative implication for boards that choose not to provide a self-assessment. There is no reason to affirmatively state that boards may voluntarily provide self-assessments, as there is no reason to think that they cannot if they so desire.

Rather than seeking or suggesting that boards provide the results of their self-assessments, the final guidance could underscore its statement in the third paragraph that "[i]n assessing board effectiveness, supervisors rely on various sources of information, including firm-provided materials and examinations." Such materials and examinations would typically provide appropriately trained and experienced examiners insight into the board's role with respect to strategy and other areas outlined in the proposal as key attributes of effective boards. These sources of information may include board actions, board materials, board and committee minutes, annual proxy statements for listed companies and informal examiner meetings with the board, board committees, groups of directors or individual directors from time to time and as appropriate, in order to discuss key issues on which the board and supervisors are focused.[18] In this regard, some firms provide to their supervisory team board meeting minutes and materials, which may, depending on individual bank practices, contain a high-level summary of the results of the annual board self-assessment or information regarding the self-assessment process. However, to the extent this summary is provided, it generally does not include the confidential details (which can include highly sensitive information) of the assessment discussion or the

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[17] The OCC Heightened Standards include board assessment expectations for certain large national banks. *See* OCC Guidelines Establishing Heightened Standards for Certain Large Insured National Banks, Insured Federal Savings Associations, and Insured Federal Branches; Integration of Regulations, 79 Fed. Reg. 54518 (Sept. 11, 2014) ("OCC Guidelines"). The OCC Guidelines state that "[a] covered bank's board of directors should conduct an annual self-assessment that includes an evaluation of its effectiveness in meeting the [standards for boards of directors set forth in the OCC Guidelines]." OCC Guidelines at 54539. Importantly, the self-assessment requirements in the OCC Guidelines, which apply at the bank level, do not have any language stating or suggesting that the self-assessments are to be shared with regulators.

[18] The appropriate format and frequency of director meetings with supervisors is ultimately dependent on the circumstances of the banking organization, and boards should have the flexibility, in consultation with supervisors, to guide the way in which these interactions take place. *See* TCH Guiding Principles, at 45 ("Depending on the issues involved, and in consultation with regulators, the board should consider whether all or part of director-examiner meetings should be in executive session without management present, and whether regulators should meet separately with the lead independent director or relevant committee chairs."); *see also* Group of Thirty, A New Paradigm: Financial Institution Boards and Supervisors (October 2013), at 23, 35 ("G30 New Paradigm") (proposing that bank boards and supervisors should devote time and efforts to their interactions and meet regularly).

responses by individual directors, which must be strictly protected to accomplish the assessment's intended purpose of candid self-reflection.[19]

In terms of the meetings, an open dialogue between directors and Federal Reserve staff on the ways in which a particular board's governance approach and/or structure aids board effectiveness is a productive tool that does not require boards to share the results of their self-assessments. Clarification of the sources of information that examiners would rely upon in making assessments is particularly appropriate because the manner in which examiners apply the proposed board effectiveness guidance will be fundamental to whether the objectives of the guidance are ultimately achieved.[20]

Although periodic examiner meetings with the board can be mutually beneficial, we believe it would be helpful to include clarifying language in the final guidance to the effect that supervisors' attendance at board or board committee meetings (other than during any portion of such meetings designated for presentations by, or discussions with, supervisors) is not appropriate. Examiner attendance at board meetings could have a chilling effect on discussions among board members and between management and board members.[21]

On the subject of board minutes, although review of board minutes by supervisors can be a useful exercise, we urge a reconsideration of the pressure by some examiners for increasingly detailed and granular minutes, as this practice creates additional leak and litigation risk.[22] In addition to board minutes, each supervisor should take into consideration its interactions with board members, board and committee meeting materials, and other corporate records to assess effectiveness. The length and specificity of board minutes should not serve as a proxy for board effectiveness.[23]

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[19] As Chairman Powell has noted, "[a]n effective board takes a preventative approach and engages in probing self-assessments regularly and systematically." Powell, *supra* note 3.

[20] For example, it would be contrary to the proposal's purpose of establishing a principles-based approach to evaluating boards if examiners were to attempt to assess boards against the illustrative examples highlighted in the guidance as if they were strict requirements.

[21] *See* G30 New Paradigm, at 23 (noting that the regular presence of supervisors, even as observers, at regular board meetings raises a concern as to whether it will chill vigorous conversation among directors).

[22] An example of supervisory guidance addressing the preparation of board and board committee minutes—and acknowledging litigation risks associated with the drafting of minutes—is the OCC Corporate and Risk Governance Handbook, which states: "The board should address the level of detail required for minutes and records of board meetings. Minutes may be subject to discovery during stockholder derivative litigation." OCC, Corporate and Risk Governance, *Comptroller's Handbook* (July 2016), at 9.

[23] As the TCH Guiding Principles note, "[t]he minutes of meetings of the board and its committees should be kept in accordance with the applicable corporate statute under which the banking organization is organized. The board should decide on the level of detail that it believes is appropriate for the minutes, balancing the need to maintain an adequate record to satisfy legal requirements and the need to avoid chilling discussion among directors. Although minutes may prove to be useful for bank regulator examiners reviewing corporate decision making they are not designed for that purpose." TCH Guiding Principles, at 42–43. *See also* TCH Guiding Principles, at 12 ("[W]e do not believe that the effectiveness of [board challenge to management] can be evaluated based on the number of challenges recorded in the minutes or elsewhere.").

III. Specific Concerns and Recommendations on the Proposal's Five Attributes of Effective Boards

In addition to highlighting our three overarching comments, we would like to provide specific feedback on each section of the proposed board effectiveness guidance.

A. The proposal's introductory discussion of "Attributes of Effective Boards of Directors" should be revised to provide a clear description of core board functions.

The proposal is intended to refocus supervisory expectations for boards on the board's core responsibilities, but it does not provide a definition or conclusive description of "core responsibilities" of boards. Instead, in the introduction to *Attributes of Effective Boards of Directors*, the proposal refers to a non-exclusive list of matters that are included within a board's core responsibilities. We are concerned that this approach could lead to a creeping expansion of which responsibilities are considered to be "core." The issues that the board will need to confront and the circumstances in which a board's core responsibilities apply may change over time, but the board's fundamental role and core responsibilities generally do not.[24] We suggest that the final guidance include a clear description of "core responsibilities" and believe that the core board functions identified by the TCH 2016 Directors Report are appropriate components of this definition.[25]

In addition, we believe that the introduction to the final guidance would be an appropriate place to emphasize that the specific examples in the final guidance are for illustrative purposes only and may not be appropriate or applicable to all institutions, as discussed in Part II.A above.

Although there should be a clear understanding of the core board functions to aid in effective board supervision and oversight, the precise structures and approaches through which a particular board determines to carry out core functions will appropriately differ.

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[24] *See* TCH 2016 Directors Report, at 9. In addition, in *The Transforming Role of the Bank Board*, Paul Harris and Gregg Rozansky note that:

> There is perhaps a natural temptation to consider new risks as somehow different from existing ones—requiring new structural approaches or prescriptive solutions such as a fundamentally different approach to board governance. Experience has shown that the hot topics on the board agenda today may change over time, but the distinction between the role of the board versus that of management remains a core precept for effective governance.

[25] The core board functions for large U.S. banking organizations identified by the report are: (1) reviewing and approving the firm's strategic objectives and plans, (2) monitoring financial performance and condition, (3) talent management for the CEO and other senior executives, (4) overseeing the risk management and internal control frameworks, including top-tier policies and plans in fundamental areas and (5) reinforcing, demonstrating and communicating the "tone at the top" for the values and culture of the organization and overseeing the enterprise-wide approaches/programs intended to promote organizational values, culture and reputation. TCH 2016 Directors Report, at 8–13.

B. The proposal's discussion of the first attribute (Set Clear, Aligned, and Consistent Direction) should be revised to more clearly distinguish the role of the board in overseeing strategy from management's role in developing and executing it.

To align the language in the first attribute with the stated goals of the proposal, the first attribute should be revised to more clearly distinguish the role of the board in overseeing strategy, which is to oversee management's development and execution of the strategy, from management's role.[26] To accomplish this, we propose to revise the paragraph describing a "clear strategy" as follows:

> A core function of a board is its oversight of the firm's strategy. A board should review and advise management on the firm's strategic direction and strategic plans, concurring in or challenging management's approach as needed. While each firm must determine its own processes and procedures for management's development of, and the board's oversight of, the firm's strategic objectives and more detailed strategic plans, as a backdrop, both the board and management should take into account the firm's risk appetite, resources and controls when considering strategy.

Consistent with these revisions, the title of the first attribute should be changed to "Oversee Clear, Aligned and Consistent Strategy."

As discussed above, the first attribute identifies "significant" policies, programs and plans that an effective board assesses and approves (and provides standards for this assessment that may not be appropriate in every case). These include capital and resolution and recovery plans, which are often detailed, technical and voluminous. Many firms provide directors with these plans for reference, but also include summaries that management reviews with the board prior to the board's formal approval. The guidance should state explicitly that directors can rely on summaries prepared by management and third-party experts, and that a board's review and approval is part of its oversight role.[27] The scope of the "significant" policies, programs and plans should also be narrowed, where appropriate (*e.g.*, by specifying that an effective board assesses and approves "incentive compensation and performance management programs" for *senior management*).

More generally, there should be a distinction between significant policies and programs that tend to remain relatively constant (*e.g.*, enterprise-wide risk management policies and compliance risk management programs) and those strategic objectives and thresholds intended to constrain risk-taking by banking institution personnel that are updated on a more regular basis (*e.g.*, firm-wide risk tolerance). Regular review and approval of the former category of policies

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[26] *See, e.g.*, note 10 and accompanying text in Part II above.

[27] For example, in certain cases, such as with respect to voluminous capital plans and resolution plans, a board may determine that review of a sufficiently detailed summary or excerpts (including key assumptions and results), with access to supporting documentation, is sufficient to support board approval.

by the board takes a significant amount of time, even when changes are immaterial or nonexistent. Moreover, in circumstances where no meaningful changes to the policies have been proposed and absent any other specific reason for review, the exercise does not further the objective of ensuring that such policies are consistent with the organization's strategy, risk tolerance and risk management capacity.[28] At a minimum, we believe that once enterprise-wide policies and programs are approved, the board should not be required to reapprove them on an annual basis absent significant changes to the policies or the institution's activities or circumstances.[29]

The first attribute also provides that "[a] firm's strategy and risk tolerance are aligned when they are consistent, developed, considered, and approved together." Although we agree that considering strategy and attendant risks in a cohesive and coherent way is an important aspect of ensuring that a firm's strategy and risk tolerance are aligned, when interpreted by examiners, this language could be read to require that the board approve strategy and risk tolerances at the same meeting. This may not be feasible or desirable for the board or the institution based on the institution's particular circumstances and in some cases may be an iterative process. Consideration of strategy and risk tolerance should inform each other and this can be accomplished without formal approval of both at the same time.

The final guidance should acknowledge that, in overseeing a firm's corporate strategy and business plan, a fundamental objective of the board is to encourage a strategy that promotes the long-term profitability and reputation of the organization. The long-term profitability and reputation of the organization are critical to the long-term safety and soundness of the bank.

In defining "senior management," which in the proposal refers to individuals directly accountable to the board of directors for the sound and prudent day-to-day management of the firm,[30] the final guidance should acknowledge the limited scope of members of management that would fit within this definition. Outside of the chief executive officer ("CEO"), who would invariably fall within the meaning of the term, each board should be able to define which group of executives constitutes its "senior management" for purposes of board oversight of "senior management." We recommend including language to the effect that the specific individuals making up a firm's senior management team may vary from institution to institution, consistent with the view that there is no "one-size-fits-all" standard, and that the determination as to which individuals are considered "senior management" is one that should be made from time to time by the CEO in consultation with the board.

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[28] In contrast, more regular review by the board of specific enterprise-wide risk limits and other metrics that do change regularly provides identifiable benefits, including familiarity with useful quantitative measures that the board approves and then uses in holding management accountable.

[29] In fact, the OCC has taken the position that "board or risk committee approval of material policies under [the institution's risk governance framework] would be burdensome, and that these policies should be approved by management instead." OCC Guidelines, at 54526.

[30] 82 Fed. Reg. 37219, 37227 (footnote 18).

C. The proposal's discussion of the second attribute (Actively Manage Information Flow and Board Discussion) should clarify that the "right" methodology for boards to use in obtaining and evaluating information depends on numerous factors and varies for each board.[31]

Although information flow to the board—which includes consideration of the timeliness with which the board receives material information and the pertinence and clarity of such information—is an important element of corporate governance effectiveness, the final guidance should recognize the board's oversight role and the applicability of the no "one-size-fits-all" approach in describing the second attribute. As an initial matter, we caution against using the word "active" to describe the board's role in managing information flow without further defining what "active" means in this context,[32] as it may inappropriately suggest that a board must assume management functions and responsibilities. The final guidance should recognize that the "board's approach to, and level of engagement on, particular issues and proposals will vary depending upon a number of considerations such as the criticality of the matter at issue and the comprehensiveness of prior reviews and analysis."[33] The "right" methodology for boards to use in obtaining and evaluating information depends on numerous factors, including the nature and form of the information, and varies for each board. Relatedly, directors should, of course, consider the need for updated, refocused and/or expanded director education and training to ensure an appropriately knowledgeable perspective on key matters and developments for purposes of carrying out their oversight responsibilities, but boards should have the flexibility to determine if and when such sessions would be most useful and how the sessions should be conducted.

In addition, the second attribute 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 lead independent director has primary responsibility for setting the agenda for the full board in consultation with management and other directors. In addition, in most cases, the chair of a board committee has primary responsibility for setting the agenda for the committee, in consultation with management and other committee members.[34] A board member should be

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[31] The title of the second attribute should be changed to "Oversee Information Flow and Manage Board Discussion."

[32] For a discussion of actions that may constitute "informed and active engagement" by directors in the performance of core board functions, *see* Section II of the TCH 2016 Directors Report, at 14–15.

[33] *Id.*, at 15.

[34] The Federal Reserve's press release announcing the cease and desist consent order with Wells Fargo, issued on February 2, 2018, and the related letters sent by the Federal Reserve to the current directors, former chair and former lead independent director of the Wells Fargo board stated that the performance of the directors, former chair and former lead independent director had not been consistent with the Federal Reserve's expectations under the circumstances. The press release, as well as the related letters, are available at https://www.federalreserve.gov/newsevents/pressreleases/enforcement20180202a.htm. Some have speculated that the Federal Reserve may have intended to signal a change in the supervisory standards applied to independent directors and independent chairs of boards of directors rather than simply make a statement limited in application to a unique set of circumstances.

permitted to choose to provide input on the agenda through a board or committee chair, a lead independent director or otherwise, and the proposal should be clarified to recognize this flexibility. In setting agendas, while appropriate consideration should be given to any input from board or committee members, without this clarification, the proposal could be read to suggest that all directors must "take an active role" in setting meeting agendas, which could lead firms to feel they must engage in a rote exercise to demonstrate compliance with the statement. The final guidance should emphasize that each firm should establish governance practices for the board that are appropriate for that particular firm.

To illustrate the point that directors should take an active role in setting board meeting agendas, the description of the second attribute goes on to provide an example of a meeting at which the board discusses a new business strategy "simultaneously, or in connection, with a discussion of risk management capabilities of the new business and of internal audit's perspective on relevant controls." As discussed above, we are concerned that this could lead to an expectation by examiners that risk assessments occur simultaneously with strategy discussions, which may not be appropriate depending on the circumstances of the institution.

Regarding the board's processes to evaluate information flows, the final guidance should note that receiving too much unfiltered information often can impair board effectiveness to the same extent as receiving too little pertinent information. As discussed in Part III.B above, the final guidance should recognize that directors can rely reasonably on summaries prepared by management and third-party experts, as part of the board's oversight role.

D. The proposal's discussion of the third attribute (Hold Senior Management Accountable) should be more consistent with the board's oversight role and should clarify that the board's engagement with senior management need not be adversarial.

As a general matter, it is appropriate in all cases for the board of directors to evaluate and concur in or approve the succession plan for the CEO. With respect to the succession plans for other members of senior management,[35] the discussion of the third attribute should more clearly recognize that each board or designated board committee has flexibility to identify whose

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A board acts collectively, but as noted earlier, may delegate its functions to a board committee or to a director in a leadership role, such as a board or committee chair or a lead independent director. Both the board and the committee should then appropriately tailor their agendas, with the board chair (or lead independent director) having the primary role in reviewing the board agenda, and the committee chair having the primary role in reviewing the committee agenda. In delegating its functions to a committee or to a director in a leadership role, the board as a whole remains responsible for meeting its obligations. Because of the continuing importance of attracting highly capable individuals to serve as directors and take on more specific board functions, neither a committee in exercising its authority nor an individual director in assuming a leadership role in one or more board functions should be held to a heightened standard of liability in comparison to directors generally. *See* TCH Guiding Principles, at 29 (noting that "the delegation of responsibilities and functions to standing or temporary committees does not relieve the full board of general oversight responsibility over those functions").

[35] The term "senior management" is used throughout the description of this attribute, and as discussed above, this term should be appropriately limited.

succession plans are to be considered by the board or one of its committees, based on the firm's particular needs and circumstances.

The TCH Guiding Principles note:[36]

> A management succession plan can be in many forms, and need not specify definitive successors. Instead, the plan often will lay out a clear process that will be implemented when a need, or potential need, for a successor arises, and may include a group of identified potential candidates. Regardless of the format, the management succession plan should be designed to prevent a change in management from impacting the efficient operation of the organization and the continued safety and soundness of its bank subsidiaries.

The discussion of the third attribute includes an expectation that the board "establishes and approves" clear financial and nonfinancial performance objectives for the CEO, CRO and chief audit executive ("CAE") and, as appropriate, for other members of senior management.[37] The final guidance should be reworded to remove the reference to "establishes." This change would be consistent with the board's oversight role and would avoid the risk of inappropriately involving the board in day-to-day management of the firm.

In addition, we caution against requiring prescriptive or rigid performance objectives (*e.g.*, specific benchmarks, formulaic metrics or targets) on an ex-ante basis as they do not take into account unforeseen circumstances such as new priorities and economic environments. Accordingly, evaluating members of senior management against prescriptive or rigid performance objectives may have unintended consequences or create unintended incentives. Although evaluations of senior management should reflect strategic and risk elements, the proposal as written would seem to require the board to specifically establish and/or approve performance objectives for ultimate assessment of performance rather than permitting the board to consider factors that it deems in its judgment to be appropriate under the circumstances consistent with its performance objectives or priorities. Requiring the board to consider prescriptive or rigid performance metrics in a way that places undue focus on achieving these metrics without considering holistic performance or placing such performance in the context of the exigent business and economic environment could hinder an institution's ability to design an executive compensation program that appropriately incentivizes members of senior management to act prudently. The board should review, and receive sufficient information to assess, the performance of senior management officials, but it need not formally approve performance objectives as a separate responsibility. Depending on the circumstances applicable to a particular firm, it may or may not be appropriate to incorporate previously established or approved financial and non-financial performance objectives or priorities into the assessment of

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36 TCH Guiding Principles, at 23.

37 *See* Part III.B above for a discussion of the term "senior management."

a given member of senior management.[38] Finally, the final guidance should clarify that a board or board committee could approve or assess any established performance objectives or priorities as appropriate in the judgment of the board or board committee.

While holding management accountable for its performance is an inherent aspect of core board functions, the discussion of the third attribute should also be clarified to provide that the board's engagement with senior management need not be adversarial. For example, it may be appropriate for a board to promote management accountability by discussing underlying assumptions with or requesting supporting or additional information from management rather than "debating" information presented.[39]

The proposal refers to a lead independent director with the authority to set agendas or to call board meetings with or without the "CEO and board chairman present." This statement should be clarified in the final guidance to provide that a board of directors does not need an independent lead director if the board has an independent chairperson.[40]

E. The proposal's discussion of the fourth attribute (Support the Independence and Stature of Independent Risk Management and Internal Audit) should be revised to better clarify the distinctions between the roles of the board and management and acknowledge that boards generally have flexibility to determine where particular elements of risk oversight are centered.

We would like to highlight a few examples in the fourth attribute that we believe, contrary to the proposal's intent, blur the distinction between the roles of the board and management. First, the proposal provides that an effective risk committee supports the stature and independence of the independent risk management function by, among other things,

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[38] Setting financial performance objectives for certain members of management (*e.g.*, the CRO and CAE) may be inconsistent with promoting the safety and soundness of the institution. For example, under Regulation YY, bank holding companies must ensure that compensation and other incentives provided to the CRO are consistent with providing an objective assessment of risks taken by the bank holding company. *See* 12 C.F.R. § 252.33(b)(3)(i).

[39] The TCH 2016 Directors Report notes that "[i]nformed and active engagement in the performance of core board functions, including what at times has been referred to as "challenges" to management, may be exhibited through several different types of actions." For an illustrative list of these actions, *see* TCH 2016 Directors Report at 14-15. *See also*, OCC, Corporate and Risk Governance, *supra* note 22, at 118 (defining "credible challenge" as "[t]he method that directors use to hold management accountable by being engaged and asking questions and eliciting any facts necessary, when appropriate, to satisfy themselves that management's strategies are viable and in the bank's best interests"). The TCH Guiding Principles point out that "[t]he board and management share an interest in the successful implementation of an agreed plan and a board should, in the normal course, encourage and provide positive feedback on steps likely to lead to that outcome. If the board determines that management's implementation of an agreed plan is not adequate, the board should look to management for corrective measures." TCH Guiding Principles, at 21.

[40] With regard to systemically important financial market utilities like The Clearing House Payments Company, the language in Section C of the proposal should not be read to impose new requirements for director independence beyond those imposed by the Federal Reserve's Regulation HH (namely, that the board should "include a majority of individuals who are not executives, officers, or employees of the designated financial market utility or an affiliate of the designated financial market utility"). 12 C.F.R. § 234.3(a)(2)(iv)(D).

"directing the appropriate inclusion of representatives of the independent risk management function on senior management-level committees." Boards generally are not involved in directing which specific members of management sit on management committees (a clear day-to-day management function), and doing so in the normal course of carrying out oversight responsibilities would not necessarily be an attribute of an effective board.

Second, the proposal continues with a statement that the board "can effect changes" that align with the firm's strategy and risk tolerance. This language appears to cross the line between oversight and management. This language should be revised in the final guidance to provide that the board can advise or direct senior management on changes that the board believes better align the firm's strategy with its risk tolerance.

Third, the proposal provides that an "effective board can 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." We are concerned how boards would be evaluated in relation to this statement. Boards should not, for example, be subject to a "pop quiz" by examiners on whether they can identify these instances or decisions. Rather, this language could be revised to say that briefings to directors may include, as appropriate, information about such material incidents, if any, to aid in board and committee oversight.

Finally, the fourth attribute outlines characteristics of effective risk and audit committees, focusing on their roles in supporting the independence and stature of the independent risk management and internal audit functions, respectively. The proposal notes that other regulatory requirements—such as the requirement that BHCs with $50 billion or more in total consolidated assets maintain a stand-alone risk committee pursuant to the enhanced prudential standard requirements of the Federal Reserve's Regulation YY, as well as audit committee requirements contained in the SEC's Rule 10A-3 and various stock exchange requirements—establish background rules and responsibilities for these committees. We believe that the final guidance should expressly acknowledge that boards have the flexibility to determine where particular elements of risk oversight are centered, whether at the full board level or at the committee level, outside of those responsibilities prescribed by rules or regulation (*e.g.*, for the audit committee this includes overseeing the internal audit function and approving the retention of the firm's independent public accountant).[41]

We also encourage the Federal Reserve to reconsider prescriptive requirements included in Regulation YY requiring that the full board of directors: (i) approve the acceptable level of liquidity risk that the BHC may assume in connection with its operating strategies at least annually, taking into account the BHC's capital structure, risk profile, complexity, activities, and size, (ii) receive and review at least semi-annually information provided by senior management to determine whether the BHC is operating in accordance with its established liquidity risk tolerance and (iii) approve and periodically review the liquidity risk management strategies, policies and procedures established by senior management.[42] As the TCH 2016 Directors Report notes, the risk committee (or other appropriate committee) should be able to undertake the liquidity risk review required in Regulation YY.[43] At many firms, the risk committee has oversight of capital and liquidity risk management. There is no apparent reason why the risk committee (or other appropriate committee) also should not be able to monitor the firm's liquidity risk.[44]

F. The proposal's discussion of the fifth attribute (Maintain a Capable Board Composition and Governance Structure) should confirm that there is no "one-size-fits-all" standard for a board's composition, how the board conducts its meetings or the size and number of board committees.

We generally support the principles outlined in the fifth attribute, but emphasize that board composition and governance structure appropriately vary by institution. The final guidance should confirm that there is no "one-size-fits-all" standard for a board's composition, how the board conducts its meetings or the size and number of board committees, and that supervisors and examiners applying the guidance should not develop or demand conformity with uniform standards or perceived "best practices" across organizations.

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41 *See, e.g.*, Federal Reserve System, *Enhanced Prudential Standards for Bank Holding Companies and Foreign Banking Organizations*, 79 Fed. Reg. 17240, 17250 ("The risk committee may have members that are on other board committees, and *other board committees, such as audit or finance, may have some involvement in establishing a banking organization's risk management framework*.") (emphasis added); *id.* at 17248 ("[B]oards of directors routinely delegate oversight responsibilities for particular aspects of a company's operations to committees in order to more efficiently allocate responsibility among the directors."); *see also* TCH Guiding Principles, at 38 ("[T]he board may determine that elements of risk oversight relating to particular areas, such as technology, compliance, reputation, compensation, corporate responsibility, financing or credit exposures, among others, are best housed within committees that focus on these areas, so long as the overall board structure provides for appropriate enterprise-wide risk oversight.").

For NYSE listed bank holding companies, audit committees are also responsible for oversight of compliance with legal and regulatory requirements.

42 12 C.F.R. § 252.34(a).

43 TCH 2016 Directors Report, at 23.

44 *See id.*

Boards continually evaluate the experience, qualifications, attributes and skills of current board members. Nominating and governance committees typically review a broad range of potential director candidates. Current regulatory requirements (*e.g.*, SEC rules, stock exchange listing standards, Regulation YY) also prescribe qualifications for members of audit, risk, nominating and governance and compensation committees. Given the nature of this process, boards are best placed to nominate for election directors whom they believe would best contribute to the tapestry of the board as a whole to assist the board in discharging its duties and overseeing the firm's strategy.

The proposal describes the governance structure of an effective board as including "management-to-committee" reporting lines. This reference should not be interpreted to expand existing regulatory requirements or to suggest that an effective board must have additional management-to-committee reporting lines.

The ability of a board of directors to delegate functions to a committee of the board is a fundamental principle of corporate law.[45] The final guidance should expressly recognize this principle and state 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 the board may determine which of its committees is appropriate, subject to regulatory or other legal requirements. We believe this principle should be included in the discussion of the fifth attribute and would serve to clarify footnote 9 of the proposal, which states that references to "board" or "board of directors" also refer to committees of the board of directors, "as appropriate." It is important that the Federal Reserve recognize, both in the final board effectiveness guidance and in all of its guidance, that the board has the ability to delegate to a committee the authority to address board responsibilities that are properly within the scope of the committee's purpose in order to efficiently allocate responsibility among directors.[46]

It is essential that boards of banking organizations, like other corporate boards, be entitled to rely reasonably on the records of the organization and on the information provided to the board by management, board and management committees, employees, consultants, attorneys and advisors where there is no reasonable basis to believe that such reliance is unwarranted. Without this, the board would be consumed by minute details of the management and supervision of the organization, contrary to the goals of the proposal and sound corporate governance. The board's ability to rely on this information is consistent with protections afforded directors under applicable state laws as well as with the board's oversight role. The Federal Reserve should state this reliance principle in the final guidance.

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[45] *See* TCH 2016 Directors Report, at 23; Delaware General Corporation Law § 141.

[46] For example, it should be understood that a board may delegate to a committee its responsibility for assessing "significant" policies, programs and plans for consistency with the firm's strategy, risk tolerance and risk management function. 82 Fed. Reg. 37219, 37225. As an illustrative example in other guidance, it should be understood that a committee (such as the audit committee) may appoint the CAE to satisfy the (proposed) expectation in the proposed rating system for large financial institutions that the firm should have a CAE, appointed by the board. 82 Fed. Reg. 39049, 39055.

IV. The Federal Reserve should work quickly toward completing its review of existing expectations of boards and, in the interim, examiners should take a measured approach, recognizing the forthcoming changes to these expectations.

We endorse the Federal Reserve's efforts to review all existing supervisory expectations and regulatory requirements relating to boards of directors and rescind or revise those that do not relate to the board's core responsibilities or are not aligned with the Federal Reserve's supervisory framework. We describe in Part IV.A several common categories of requirements that should be rescinded or revised, and, in Part IV.B, we identify additional Supervision and Regulation (SR) letters that should be subject, among others, to the first phase of the Federal Reserve's review.[47]

We recognize that revising interagency guidance requires collaboration and coordination with the other agencies, but note that many of the most onerous board requirements appear in the interagency guidance. As an example, the Interagency Guidance on Leverage Lending, issued on March 21, 2013, inappropriately conflates the roles of the board and management by stating that the "board of directors and management should establish clear expectations for the disposition of pipeline transactions that have not been sold according to their original distribution plan."[48] As part of the second phase of the Federal Reserve's review of existing board requirements and supervisory expectations, the significant requirements for boards of directors in regulations such as the Volcker Rule,[49] the requirement that the board approve and regularly review a bank's program for the retail sales of nondeposit investment products,[50] the requirement that the board review and at least annually approve the firm's net debit cap self-assessment and recommended cap category[51] and the requirement that board members "ensure that the level of model risk is within their tolerance and direct changes where appropriate"[52] should also be conformed with the principles set out in the proposal. We urge the Federal Reserve, working with the other agencies, to complete a review of and issue revised interagency guidance promptly, and we respectfully request the opportunity to comment on the regulations, interagency guidance and any other requirements identified in the second phase of the Federal Reserve's review.

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[47] *See* 82 Fed. Reg. 37219, 37223 (seeking input on which Federal Reserve supervisory expectations not included in Table A of the proposal should be revised or rescinded).

[48] We note that the U.S. Government Accountability Office concluded in October 2017 that the Interagency Guidance on Leverage Lending is a "rule" under the Administrative Procedures Act and therefore is subject to the Congressional Review Act.

[49] *See, e.g.*, 12 C.F.R. § 248, App. B, Section III.

[50] Federal Reserve System, Federal Deposit Insurance Corporation, Office of the Comptroller of the Currency and Office of Thrift Supervision, *Interagency Statement on Retail Sales of Non-Deposit Investment Products* (Feb. 15, 1994).

[51] Federal Reserve System, *Federal Reserve Policy on Payment System Risk* (Sept. 15, 2017), at 22.

[52] Federal Reserve System and Office of the Comptroller of the Currency, *Guidance on Model Risk Management*, SR Letter 11-7 (Apr. 4, 2011).

The Federal Reserve should review all of its expectations and requirements relating to boards, which in some cases also exist outside of the SR letters, regulations and interagency guidance.[53] For example, many Federal Reserve enforcement actions include requirements for the board of directors. Although we recognize that heightened oversight by the board is often required in this context, the role of the board still should not be confused with that of management. The Federal Reserve should be careful to weigh this distinction in future enforcement actions by carefully delineating with respect to remediation efforts how much, if at all, a board need go beyond its fundamental role of oversight. Similarly, the responsibilities of directors on committees charged with oversight of the organization's compliance with or remediation relating to a consent order or similar enforcement action should be carefully re-examined. The materials that the directors on these committees may be required to review on a monthly basis are often very detailed, granular or voluminous. The requirements have the effect in some cases of assigning to the board a role that is one of management of the remediation project. Consent orders are serious matters that may require additional director oversight and engagement, but the distinct roles of the board and management should be recognized and some re-balancing of responsibilities may be appropriate in this context. In addition to reviewing expectations in existing rules and guidance, the Federal Reserve should consider the objectives of the proposal in future issuances.[54]

To the extent existing expectations or requirements relating to boards apply to state member banks in addition to bank holding companies, the Federal Reserve should clarify that the rescissions and revisions to these expectations and requirements would be made with respect to both bank holding companies and state member banks, as appropriate.

In the event that the board effectiveness guidance is finalized and implemented prior to the rescission and revision of the Federal Reserve's existing expectations, it is unclear how boards should comply with such expectations to the extent they are inconsistent with a board's core responsibilities and the attributes described in the guidance. Examiners should take a measured approach during this interim period and recognize the forthcoming changes to board expectations and the likelihood that the articulation of expectations in existing guidance may be inconsistent with a board's core responsibilities as envisioned in the proposal. The Federal Reserve should expressly state that boards will not be penalized for focusing on core responsibilities when confronted with these inconsistencies.

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[53] We strongly support the Federal Reserve's plan to "make conforming changes to existing examination manuals, examination procedures, and training materials as supervisory expectations evolve over time." 82 Fed. Reg. 37219, 37227 (footnote 6). These materials should be consistent with the expectations and requirements that are rescinded or revised in conformance with the principles and objectives set out in the board effectiveness guidance.

[54] *See* The American Association of Bank Directors, *Bank Director Regulatory Burden Report* (2014 ed.) (recommending that "federal banking agencies should incorporate into their procedures a requirement that they will thoroughly consider the impact of new proposed rules or guidance on the burdens facing bank directors, including their cumulative effect, and not add to the burden of bank directors unless the benefits of the proposed rule or guidance outweigh the burdens placed on bank directors.").

We appreciate the Federal Reserve's efforts to identify and review existing supervisory expectations and regulatory requirements relating to boards. In order to maximize the benefit of the work being done, the Federal Reserve should consider including an annex to the final board effectiveness guidance that provides cross references to other applicable Federal Reserve guidance articulating board-related expectations, to the extent practicable. This would allow the final board effectiveness guidance to serve as a roadmap for institutions as they seek to develop and improve their corporate governance and risk management policies and programs.

Finally, consistent with the recommendation in the TCH 2016 Directors Report, there should be a continuing dialogue among the Federal Reserve, the other federal banking agencies, boards of directors and industry participants to identify regulatory guidance and requirements that may be inconsistent with the proposal in order to advance our common interest of promoting effective board governance at banking organizations.[55] The Federal Reserve should consider including a statement in the final guidance to the effect that any existing requirements or expectations applicable to boards of directors that are inconsistent with the new board effectiveness guidance are deemed superseded and are no longer applicable.

A. There are common categories of existing supervisory expectations and regulatory requirements that should be rescinded or revised.

We have identified the following categories of expectations and requirements relating to boards of directors that should be rescinded or revised.

- Expectations or requirements that provide for the board to "establish," "set" or "develop" should be revised to appropriately reflect the board's oversight role.

- Expectations or requirements that provide for the board to "make certain" or "ensure" that certain outcomes are achieved or actions are accomplished should be revised to avoid overstating the board's ability to control these outcomes or actions and to appropriately reflect the board's oversight role.

- Expectations or requirements that ascribe the same responsibilities to both "the board and senior management" should be revised to refer only to senior management, as noted in the preamble to the proposal.

- Expectations or requirements for board review or approval should be limited to policies, plans or other documents that are fundamental to the safe and sound operation of the institution. There should be a presumption that, unlike policies, procedures are not subject to board review or approval, which would be consistent with distinguishing oversight from management. As discussed above, directors should be expressly permitted to rely on summaries prepared by management and/or third-party experts as part of the board's review and/or approval, which would alleviate the burden of reviewing or approving those documents that may be

55 *See* TCH 2016 Directors Report, at 24.

voluminous, granular or technical (*e.g.*, resolution plans) but would not otherwise be useful to directors in carrying out their core oversight functions.

- It would be helpful to clarify that when the board is expected or required to "approve and periodically review" a plan or policy, it is not necessary for the board to undertake to again review and/or approve these documents unless there are material changes to the plans or to the firm's activities that are the subject of the documents or as management may deem appropriate.

- Expectations or requirements that are redundant, unnecessary or outdated should be eliminated. The Federal Reserve should periodically review its regulations and guidance for these items.

- The board should be expressly permitted to delegate its responsibilities to a board committee of its choosing, unless statutorily prohibited or clearly prescribed under other applicable rules.

B. There are several SR letters not listed in Table A of the proposal that include board requirements or expectations that should be rescinded or revised.

We agree that the SR letters the Federal Reserve has identified contain board requirements or supervisory expectations that are inconsistent with the goals of the proposal. We have identified the following additional SR letters that also contain board requirements or supervisory expectations that we believe should be rescinded or revised consistent with the Federal Reserve's goals as stated in the preamble to the proposal. In addition, we believe that any requirements or supervisory expectations in the SR letters identified by the Federal Reserve or this letter or otherwise that fall within the categories listed above should be rescinded or revised.[56]

- SR Letter 15-18: Federal Reserve Supervisory Assessment of Capital Planning and Positions for LISCC Firms and Large and Complex Firms:[57]

    - SR 15-18 includes requirements for the board of directors to review information that may be overly technical or detailed. For example, it states that the "board should direct senior management to provide information about the firm's estimation approaches, model overlays and assessments of model performance."

    - In accordance with the discussion above, the requirement for the board to "approve policies related to capital planning, and review them annually" should be subject to a threshold standard that such policies are fundamental to safety and

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56 In proposing revisions to expectations for boards of directors contained in Federal Reserve guidance, we are not commenting on whether the guidance is or is not a "rule" subject to the Congressional Review Act.

57 Federal Reserve System, Division of Banking Supervision and Regulation, *Federal Reserve Supervisory Assessment of Capital Planning and Positions for LISCC Firms and Large and Complex Firms*, SR Letter 15-18 (Dec. 18, 2015).

soundness, as determined by the firm. Similarly, the requirement for senior management to "highlight for the board any problem areas related to capital planning" (emphasis added) should be limited to problem areas that are significant enough to warrant board attention.

- Regarding the statement that a board should "maintain an accurate record of its meetings pertaining to the firm's capital planning process," it is unclear what the reference to "accurate records" means in this context. This requirement should not expand the record-keeping responsibilities of the board beyond the normal process of recording minutes.

➢ SR Letter 13-1/CA Letter 13-1: Supplemental Policy Statement on the Internal Audit Function and its Outsourcing:[58]

- The statement that internal audit should "confirm that the board of directors and senior management are actively involved in setting and monitoring compliance with the institution's risk tolerance limits" should be revised to refer only to senior management, with the board providing oversight.

- The requirements that "the board of directors and senior management" are responsible for "ensuring that the institution has an effective system of internal controls" and "for ensuring that internal controls are operating effectively" should be revised to remove the references to the board. The requirements otherwise also inappropriately suggest that the board can "ensure" these outcomes.

- SR 13-1 includes a detailed list of requirements—such as descriptions of responsibilities and related processes, approval requirements, minimum formal meeting requirements and a list of data sets required to be reviewed—applicable to the audit committee of the board of directors. These requirements should be revisited in order to focus on the "core" responsibilities of the audit committee in the context of the internal audit function.

➢ SR Letter 91-4: Guidelines for the Inspection of Investment Adviser Subsidiaries of Bank Holding Companies:[59]

- The statement that each of the board and senior management is involved in "establishing, communicating and enforcing a system of policies, procedures and practices suitable to [the institution's] business objectives and legal requirements" should be revised to remove the reference to the board.

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[58] Federal Reserve System, Division of Banking Supervision and Regulation, *Supplemental Policy Statement on the Internal Audit Function and Its Outsourcing*, SR Letter 13-1/CA Letter 13-1 (Dec. 18, 2015).

[59] Federal Reserve System, Division of Banking Supervision and Regulation, *Guidelines for the Inspection of Investment Adviser Subsidiaries of Bank Holding Companies*, SR Letter 91-4 (Feb. 8, 1991).

- The requirement that the institution's "general investment standards, review and selection responsibilities" be "defined and approved" inappropriately assigns management responsibilities to the board and should be clarified or rescinded.

V. We strongly endorse the proposed guidance on communication of supervisory findings.

We strongly endorse the proposed guidance on communication of supervisory findings, which would supersede SR letter 13-13/CA letter 13-10.

We support the proposal that Federal Reserve examiners and supervisory staff would direct most supervisory findings to senior management for corrective action. As noted by Chairman Powell and former Governor Daniel Tarullo, the practice of directing all examination and inspection findings to the board is "almost surely distracting from strategic and risk-related analyses and oversight by boards."[60] We would expect that senior management would establish a process to inform the board, or an appropriate board committee, of material findings, which may include thematic summaries. This should alleviate any potential concerns with directing supervisory findings to senior management, rather than the board, for corrective action.[61]

We suggest revising the reference to the board's responsibility to "establish" policies that direct senior management regarding how to manage the MRIAs and MRAs and when to escalate them to the board by substituting an "oversight" standard consistent with our comments above.

With respect to matters that are referred or escalated to the board, it is important for the Federal Reserve to recognize that boards may determine whether these matters are to be addressed by the board or a board committee.[62] Furthermore, if the board determines that these matters are to be addressed by a board committee, the board should have the flexibility to determine which board committee would be most appropriate. In that regard, we suggest changing the reference in the proposal that provides that matters may be escalated to an "executive-level" committee of the board to refer to a "standing committee of the board, such as the audit committee or risk committee of the board or a special purpose committee such as one responsible for oversight of the organization's compliance with or remediation relating to a consent order or similar enforcement action" or, alternatively, adding a clarifying footnote to the

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[60] Powell, *supra* note 3; Governor Daniel J. Tarullo, *Corporate Governance and Prudential Regulation*, Association of American Law Schools Midyear Meeting (Jun. 9, 2014).

[61] Additionally, boards would "continue to receive copies of examination and inspection reports, including formal communications with the institution." *See* Powell, *supra* note 3.

[62] Chairman Powell has acknowledged that "a board may choose to track progress and closure of MRAs through an appropriate board committee, rather than getting into the granular detail on every individual MRA." Powell, *supra* note 3.

guidance explaining that the reference to an "executive-level" committee of the board includes the audit committee or risk committee of the board or another appropriate committee.[63]

VI. The Federal Reserve should issue a proposal specific to boards of directors of IHCs that is based on the same principles of distinguishing board oversight from management and refocusing board attention on core responsibilities, but also takes into account the differences in the role of the IHC and its board from a U.S. top-tier bank holding company and its board as well as the variation in governance approaches among IHCs.[64]

The Federal Reserve states in the proposal that the proposed board effectiveness guidance would not apply to IHCs established pursuant to Regulation YY, and the Federal Reserve anticipates issuing separate proposed board effectiveness guidance for IHCs at a later date.[65] We support an IHC-specific proposal that is based on the same principles of distinguishing board oversight from day-to-day management and refocusing board attention on core responsibilities, while taking into account the differences in the role of the IHC and its board from a U.S. top-tier BHC and its board as well as the variation in governance approaches among IHCs.

Many important board functions and responsibilities are carried out differently for boards of IHCs as compared to boards of U.S. top-tier BHCs due to the relationship between an IHC and its foreign parent.[66] An IHC operates as an intermediate company within the global strategic framework of its foreign parent rather than as a standalone enterprise. As a subsidiary of a parent financial institution that is subject to home-country supervision and regulation, an IHC needs to ensure that its strategy and risk management and corporate governance policies and programs align with the parent's global regulatory framework. In addition, a key responsibility of an IHC board typically includes escalating issues, pursuant to an appropriate escalation

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[63] *See, e.g.*, Federal Reserve System, Division of Banking Supervision and Regulation, *Supervisory Considerations for the Communication of Supervisory Findings*, SR letter 13-13/CA letter 13-10 (Jun. 17, 2013), footnote 2, which clarifies that each of the audit committee and the risk committee is an executive-level committee of the board.

[64] *See* 82 Fed. Reg. 37219, 37223 (seeking input on how the proposed board effectiveness guidance and refocusing of existing supervisory guidance should be adapted for IHCs).

[65] There is some confusion regarding whether, as currently drafted, the proposal would apply to IHCs that are also BHCs. For the reasons discussed in this section, the Federal Reserve should clarify that the proposal does not apply to such entities, and the Federal Reserve should issue guidance applicable to all IHCs. The important corporate governance considerations for IHCs highlighted in this section are relevant whether or not the IHC is also a BHC. If the Federal Reserve instead takes the position that the proposal applies to IHCs that are also BHCs, the considerations discussed in this Part VI should be addressed with respect to those entities. The Federal Reserve should also include a statement to the effect that there may be additional and/or different laws, regulations and other factors applicable to U.S. BHCs that are subsidiaries of foreign banking organizations that present certain unique issues and, as a result, the boards of such entities necessarily have the flexibility to rely on processes and take actions as appropriate given their respective institutions' particular circumstances.

[66] *See* TCH Guiding Principles, footnote 1 (noting that the TCH Guiding Principles are "principally designed for U.S. banking organizations because non-U.S. banking organizations (including their U.S. subsidiaries and other U.S. operations) are generally subject to a different set of governing laws, regulations and relationships presenting certain unique issues and considerations not addressed in [the TCH Guiding Principles].").

protocol, to its foreign parent (*e.g.*, if a strategic mandate from the foreign parent would present potential safety and soundness risks or legal concerns in the context of the U.S. operations). There is also great variation among IHCs due to the different sets of business models, governing laws, regulations and supervisory processes to which these entities are subject.

For these reasons, proposed guidance for IHCs should differ in several important ways from the present proposal. For example, a board of directors of an IHC should focus on aligning the IHC's strategic objectives, corporate values and corporate governance principles with its parent bank while at the same time overseeing management in ensuring that the IHC's risk profile and financial condition are consistent with safe and sound operation of the IHC.

IHC boards do not generally "guide the development" of the firm's global strategy or "set the types and level of risk" the firm is willing to take.[67] Because the IHC is a subsidiary of a foreign banking organization, the IHC board's responsibility should be to review and approve the firm's strategy as it applies to the IHC's operations in line with the risk tolerance established for the IHC and the requirements of the Federal Reserve's Regulation YY.

Similarly, IHC boards do not generally establish "financial and nonfinancial performance objectives" for the CEO, CRO, CAE or other members of senior management. These objectives are generally determined at the parent level. The IHC board typically reviews these performance objectives in line with the IHC risk management framework, the strategy as applied to the IHC and the requirements of Regulation YY, and makes recommendations to the parent board. The proposed guidance issued for IHCs should also be tailored to align to the specific governance requirements for IHCs in Regulation YY and, subject to these requirements, emphasize there is no "one-size-fits-all" standard.

The Federal Reserve should also recognize that the composition of IHC boards will often differ from those of U.S. top-tier BHCs, which are typically publicly listed companies. Although it may be appropriate to expect a majority independent board at the parent company level (as is the case for most U.S. top-tier BHCs), this standard may or may not be appropriate for an IHC. The IHC board must operate pursuant to the strategy set at a global level by the parent board and global management, while at the same time fulfilling its obligations under Regulation YY and applicable state law. In this context, the IHC board must closely collaborate and communicate with the parent board, receive regular input from senior global managers and engage the parent's independent directors' views. It is therefore often appropriate for an IHC to include members of the parent board and representatives of senior management on the IHC's board, while complying with the requirements of Regulation YY (*e.g.*, that at least one member of the IHC's risk committee be independent[68]).[69] The recommended IHC proposal should acknowledge this

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[67] *See, e.g.*, Basel Committee on Banking Supervision, *Corporate governance principles for banks* (July 2015), at 23 ("While parent companies should conduct strategic, group-wide risk management and prescribe corporate risk policies, subsidiary management and boards should have appropriate input to their local or regional application and to the assessment of local risks").

[68] 12 C.F.R. § 252.153(e)(iv).

important difference between parent-level and IHC boards, and as a result not set expectations regarding the composition of the IHC board beyond the requirements already mandated by Regulation YY.

According to the Federal Reserve's proposed guidance establishing a new rating system for large financial institutions, the new rating system would apply to IHCs. We are concerned how IHCs would be evaluated under this new rating system, and in particular, its governance and controls component, in the absence of guidance for a supervisory framework specific to boards of directors of IHCs. For example, it is unclear whether supervisors, in assigning ratings to IHCs, would evaluate IHC boards based on any of the attributes described in the proposal or whether supervisors would evaluate IHC boards in a "vacuum." We urge the Federal Reserve to issue a proposal for this IHC-specific guidance as promptly as possible and with sufficient time to complete a notice and comment period before the new ratings system goes into effect for IHCs.

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[69] Indeed, in the IHC context, the foreign parent typically sets standards for and selects directors to sit on the IHC board, rather than a nominating and governance committee made up of independent directors as is the case for many top-tier U.S. BHCs.

We appreciate the opportunity to comment on the proposal. If you have any questions, please do not hesitate to contact any of the undersigned.

Respectfully submitted,

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