COMMITTEE ON CAPITAL MARKETS REGULATION

October 3, 2017

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

VIA ELECTRONIC MAIL: regs.comments@federalreserve.gov

Re: Docket No. OP-1570; Proposed Guidance on Supervisory Expectation for Boards of Directors (the "**Proposed Guidance**")

Dear Ms. Misback:

The Committee on Capital Markets Regulation (the "**Committee**") is grateful for the opportunity to comment on the Proposed Guidance by the Federal Reserve System (the "**Federal Reserve**") regarding supervisory expectations for the boards of directors of financial institutions supervised by the Federal Reserve ("**BE Guidance**").[1]

Founded in 2006, the Committee is dedicated to enhancing the competitiveness of U.S. capital markets and ensuring the stability of the U.S. financial system. Our membership includes thirty-nine leaders drawn from the finance, investment, business, law, accounting, and academic communities. The Committee is chaired jointly by R. Glenn Hubbard (Dean, Columbia Business School) and John L. Thornton (Chairman, The Brookings Institution) and directed by Hal S. Scott (Nomura Professor and Director of the Program on International Financial Systems, Harvard Law School). The Committee is an independent and nonpartisan 501(c)(3) research organization, financed by contributions from individuals, foundations, and corporations.

The Committee commends the Federal Reserve for its efforts to clarify supervisory expectations for boards of directors, refocus these expectations on boards' core functions, and distinguish them from supervisory expectations for senior management. The Committee is concerned, however, that the BE Guidance could be interpreted as imposing rigid and prescriptive rules for how a board should fulfill its functions. The Committee encourages the Federal Reserve to clarify that it is not setting specific, binding requirements about how boards must act to effectively carry out their core responsibilities.

[1] Proposed Guidance on Supervisory Expectation for Boards of Directors, 82 Fed. Reg. 37,219 (proposed Aug. 9, 2017).

The BE Guidance

The BE Guidance[2] applies to the boards of directors of banks with assets of $50 billion or more and all systemically important nonbank financial companies.[3] The BE Guidance identifies five key attributes of effective boards that the Federal Reserve believes will support safety and soundness, provide a framework to assess board effectiveness, and better distinguish the supervisory expectations of boards and senior management:[4]

(1) Set clear, aligned, and consistent direction regarding the firm's strategy and risk tolerance;
(2) Actively manage information flow and board discussions;
(3) Hold senior management accountable;
(4) Support the independence and stature of independent risk management and internal audit; and
(5) Maintain a capable board composition and governance structure.[5]

The BE Guidance also includes examples of how an effective board would satisfy each of these five key attributes.

Analysis of the BE Guidance

The Federal Reserve's efforts to focus supervisory expectations for boards of directors on core board functions and to more clearly delineate board and management roles are critical to enable boards to carry out their core responsibilities. Board resources and time spent on responsibilities more appropriately handled by management detract from the board's ability to guide strategy and management, adopt corporate governance practices, and oversee risk management.[6]

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[2] The BE Guidance resulted from the Federal Reserve's multi-year review of practices of boards of directors and assessment of the factors that make boards effective, the challenges boards face, and how boards influence the safety and soundness of their institutions and promote compliance with laws and regulations. The Federal Reserve's review found that "supervisory expectations for boards of directors and senior management have become increasingly difficult to distinguish," and that "boards often devote a significant amount of time satisfying supervisory expectations that do not directly relate to the board's core responsibilities." *Id.* at 37,219.

[3] *Id.* at 37,219. The BE Guidance will be used in connection with the supervisory assessment of board effectiveness under the Federal Reserve's proposed Large Financial Institution rating system. The effectiveness of the board will be one of three components used to evaluate an institution's governance and controls. Governance and controls is one of three components that will be evaluated by the Federal Reserve under the Large Financial Institution rating system. The other two components are capital planning and positions, and liquidity risk management and positions. *Id.* at 37,220.

[4] *Id.*

[5] *Id.*

[6] Int'l Monetary Fund [IMF] Monetary and Capital Mkts. Dep't, *Detailed Assessment of Observance of the Basel Core Principles for Effective Banking Supervision on the United States*, at 116, IMF Country Report No. 15/89 (April 2015); *The Role of the Board of Directors in Promoting Effective Governance and Safety and Soundness for Large U.S. Banking Organizations*, THE CLEARING HOUSE, 6 (May 2016), https://www.theclearinghouse.org/-/media/action%20line/documents/volume%20vii/tch_report_the-role-of-the-board-of-directors-in-promoting-governance.pdf; 82 Fed. Reg. at 37,219.

However, the Committee is concerned that the specific examples that the Federal Reserve uses to illustrate the five "key attributes" could be misunderstood to establish specific, binding requirements to demonstrate board effectiveness, thus unintentionally creating "standardized expectations" that the Federal Reserve has indicated it is seeking to avoid.[7] We urge the Federal Reserve to clarify that the text of the BE Guidance is not intended to create prescriptive, per se rules about how effective boards must conduct themselves.

The details laid out in the BE Guidance can be read and construed as so prescriptive that they could be interpreted as mandating how a board meeting agenda is set and how much time at board meetings must be set aside for debate and discussion.

For instance, the BE Guidance states that "[d]irectors of an effective board take an active role in setting board meeting agendas."[8] Without further explanation from the Federal Reserve, an examiner could misinterpret that phrase to require that all board members personally participate in setting meeting agendas. However, there are of course many ways an effective board could choose to set meeting agendas. For example, a board may find it most effective to delegate to a lead director the task of developing meeting agendas.

Another example is the BE Guidance's statement that an effective board actively engages senior management and may do so by "structuring sufficient time" at meetings to debate information presented, encourage diverse views, and identify potential weaknesses or gaps in senior management's assessments or recommendations.[9] Again, an examiner could misinterpret that example as requiring that board agendas expressly carve out a "sufficient" amount of time dedicated to questioning senior management or debating information, when a board might more effectively initiate such discussions on an ad hoc basis over the course of a meeting as issues arise.

In the text of the final BE Guidance, the Federal Reserve should expressly affirm the importance of preserving flexibility regarding the ways in which a board can effectively discharge its fiduciary duties and supervisory expectations. To do so, the Federal Reserve should clarify that examples of effective board conduct provided in the BE Guidance are only illustrative and that examiners' assessment of board effectiveness with respect to each of the "key attributes" should be conducted based on specific facts in each individual case.

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[7] 82 Fed. Reg. at 37,220.
[8] *Id.* at 37,225.
[9] *Id.*

Thank you very much for your consideration of our views. Should you have any questions or concerns, please do not hesitate to contact the Committee's Director, Prof. Hal S. Scott (hscott@law.harvard.edu), or Executive Director of Research, John Gulliver (jgulliver@capmktsreg.org), at your convenience.

Respectfully submitted,

John L. Thornton CO-CHAIR	Hal S. Scott DIRECTOR	R. Glenn Hubbard CO-CHAIR