CENTER FOR CAPITAL MARKETS
COMPETITIVENESS

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

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

Dear Ms. Misback,

The U.S. Chamber of Commerce created the Center for Capital Markets Competitiveness ("CCMC") to promote a modern and effective regulatory structure for capital markets to fully function in a 21st century economy.[1] The Chamber believes strong corporate governance policies are important for businesses to successfully operate in a 21st century global economy.

We appreciate the opportunity to comment on the Federal Reserve's *Proposed Guidance on Supervisory Expectations for Boards of Directors* ("proposed guidance"). As the Federal Reserve correctly notes in the proposed guidance, "supervisory expectations for boards of directors and senior management have become increasingly difficult to distinguish." This recognition is a welcome step towards rectifying several issues that have arisen for boards and management through the supervisory process in recent years, and we commend the Federal Reserve for soliciting public comment on the matter.

However, we are concerned the proposed guidance is at times overly prescriptive, while at other times subjective with the potential to create open-ended standards with which it will be difficult for boards to comply. We are also concerned

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1 The U.S. Chamber of Commerce is the world's largest business federation, and represents the interests of more than three million businesses and organizations of every size, sector, and region.

that the proposed guidance could lead the Federal Reserve towards defining what constitutes an "effective" board. This will lead to subjective determinations made in future examinations, and could create regulatory conflicts as boards seek to discharge their fiduciary duty to shareholders. Our specific concerns include:

1. The Federal Reserve's supervisory expectations for boards are not sufficiently contextualized within the primary corporate governance regime, including: state law, Securities and Exchange Commission ("SEC") regulations, stock exchange listing requirements, shareholder prerogatives, or state regulation in the case of insurers that are regulated either as a savings and loan holding company or as a systemically important non-bank financial company.

2. In some cases, the text of the proposed guidance could be perceived as creating new and prescriptive requirements for boards. The guidance fails to sufficiently clarify that examples of how boards may satisfy supervisory expectations are exactly that–examples–as opposed to requirements. CCMC strongly believes that the guidance should primarily be a statement of principles, not a list of specified policies or processes.

3. In other instances, the proposed guidance uses unnecessarily subjective terms that may create open-ended questions for boards. This could lead to boards feeling they need to create an auditable trail of compliance efforts to demonstrate their conformity with the proposed guidance. Such an outcome would distract boards from their core responsibilities while doing little to promote safety and soundness.

4. The proposed guidance does not address future conflicts that could arise when the Federal Reserve makes determinations as to whether the board of a banking organization is "effective."

5. We are concerned that the language related to board assessments could be perceived to be new mandates. As such, we recommend removal of the discussion related to board self-assessments, particularly any suggestion that the results of such assessments may be provided to regulators.

6. In several instances, the proposed guidance conflates the responsibilities of senior management with the responsibilities of the board, which risks undermining the explicit purpose of the proposed guidance.

7. Due to the supervisory expectations of the Federal banking agencies, boards are now consumed with the minutiae of regulatory compliance rather than overseeing and guiding management's execution of the firm's overall strategy. This has severely disordered the U.S. corporate governance regime. The Federal Reserve should carefully scrutinize the proposed guidance text to determine if either boards *or examiners* could wrongly interpret the guidance to impose a new, unnecessary, or inappropriate compliance expectation.

Background

CCMC believes that corporate governance policies must promote long-term shareholder value and profitability, but should not constrain reasonable risk-taking and innovation. Furthermore, long-term strategic planning should be the foundation of managerial decision-making. Effective corporate governance is integral to capital formation, job creation, and economic growth. For decades, the American system of bifurcated corporate responsibilities between boards, who owe a fiduciary duty to shareholders, and management, who run the company's daily operations, has contributed to the success of an economy that is the envy of the world.

The primary corporate governance laws and regulations that apply to businesses stem from a combination of state law and, for public companies, rules administered by the SEC. In this context, the Federal Reserve's role in the corporate governance of banking organizations is secondary to that of state law and the SEC. It is critical that any requirements or expectations imposed by the Federal Reserve do not conflict with existing law or regulation.

Discussion of Concerns

As a general matter, CCMC urges the Federal Reserve to clarify that the five key attributes of effective boards are intended as *guidance*: that they do not establish substantive new requirements, that examples are not prescriptive and should not be construed as such by examiners, and that each board should consider and implement the attributes with reference to a firm's specific characteristics and circumstances. Absent such clarification, the Federal Reserve may unintentionally promote a "one-size-fits-all" approach that distracts boards from the successful execution of their core responsibilities and undermines safety and soundness.

The preamble of the proposed text states that the Federal Reserve reviewed Delaware law, SEC regulations, stock exchange listing requirements, and further asserts that the proposed guidance does not supersede or replace any applicable legal, regulatory, or listing requirements, nor is believed to be in conflict therewith. This savings clause belies the fact that these requirements are, broadly speaking, the paramount components of the U.S. corporate governance regime. Recognition of such primacy should be interwoven throughout the guidance, such that in the event a board does identify a potential conflict, Federal Reserve supervisory expectations do not displace the primary requirements.

a. <u>Vague and Subjective Terms in the Proposed Guidance</u>

One overarching concern that CCMC has with the proposed guidance is the frequent use of vague or ill-defined terms that could create questions for boards and leave many compliance determinations up to supervisors. For example, the proposal states that, in the context of the strategy for an effective board, "A [board's] clear strategy includes *sufficient detail* to enable senior management to identify the firm's strategic objectives." (Emphasis added) The term "sufficient detail" is not defined in the proposed guidance, and likely has no meaning other than what a supervisor may determine to be sufficient. Naturally, this would lead most boards to err on the side of caution and provide greater detail than may actually be necessary. Such a standard also does not properly recognize the current responsibilities for boards that exist under state law and SEC rules.

Other subjective terms regarding the characteristics of 'effective' boards include assertions that an effective board:

- "Actively" engages senior management;
- Engages in "robust" and "active" inquiry into current and emerging risks;
- Has independent directors who are "sufficiently empowered" to serve as a check on senior management;
- Directs senior management to provide information that is timely and accurate with the "appropriate level of detail" and context to enable the board to make "sound, well-informed decisions."

CCMC remains concerned that terms such as "actively," "robust," "sufficiently empowered," "appropriate level of detail," and "sound, well-informed decisions" remain ambiguous and will be left up to supervisors to define through the examination process. This could serve to create regulatory uncertainty and create inconsistent standards across the industry that will actually *decrease* boards' effectiveness and hamper their ability to act in the long-term best interests of shareholders.

It is worth noting that in a recent speech, SEC Chairman Jay Clayton stated that one of the core principles of SEC rulemaking going forward would be recognizing that regulatory costs to market participants include the costs of *demonstrating* compliance. Chairman Clayton stated that "[i]t is incumbent upon the Commission to write rules so that those subject to them can ascertain how to comply and…how to *demonstrate* that compliance." (emphasis added) Chairman Clayton further stated that "vaguely worded rules can too easily lead to subpar compliance solutions or an overinvestment in control systems."[2] CCMC strongly urges the Federal Reserve to adopt principles similar to Chairman Clayton's and to recognize that vague and subjective rules or guidance can impose significant costs on the capital markets.

b. <u>Board Self-Assessment</u>

The preamble to the guidance suggests that boards "may provide to supervisors a self-assessment of its effectiveness…which the Federal Reserve would take into consideration in its evaluation." The Federal Reserve should explicitly clarify that this language does not create a new requirement for boards to conduct a self-assessment and provide it to Federal Reserve supervisory staff. Many boards already perform such self-assessments pursuant to other components of the corporate governance regime, and in a manner designed to ensure maximum candor. The effective conversion of these evaluations into supervisory information could irreparably damage their forthrightness and utility.

Additionally, the proposed guidance opens the door to mandating self-assessments and requiring that such assessments be provided by boards to the Federal Reserve. While the guidance states that supplying such assessments is "voluntary," CCMC is concerned that it could eventually be required in order to assess board compliance with the final guidance. Should this become the case, it may decrease the

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[2] SEC Chairman Jay Clayton "Remarks at the Economic Club of New York" July 12, 2017

effectiveness of self-assessments and could lead the Federal Reserve to adopt a "best practices" approach that would not properly reflect the differences between various banking organizations. Given these concerns, we recommend removal of the discussion related to board self-assessments, particularly any suggestion that the results of such assessments may be provided to regulators.

c. Hold Senior Management Accountable

CCMC agrees that, consistent with their core oversight responsibilities, boards should hold senior management accountable for the implementation of strategy and risk tolerance and maintenance of risk management and control frameworks, and should evaluate senior management's performance and compensation. However, we are concerned that the proposed text inappropriately introduces subjective and ill-defined characterizations. Pursuant to the guidance, boards must encourage "frank discussion," and engage in "robust and active inquiry." Such nebulous modifiers invite examiners to compel board members to identify where, in meeting minutes, a discussion was sufficiently "frank" to satisfy supervisory expectations.

The proposed guidance also states that "an effective board engages in robust and active inquiry into…drivers, indicators, and trends related to current and emerging risks." The definition of 'robust' and 'active' inquiry remains unclear, and will only likely become defined through the examination process. We recommend the removal of such ambiguous and unnecessary qualifiers.

d. Support the Independence and Stature of the Independent Risk Management and Internal Audit

CCMC generally agrees that effective boards support the independence and stature of independent risk management and internal audit. We are concerned, however, that the proposed text in this section is overly prescriptive and granular. For example, the description of inquiries required to be undertaken by members of the risk or audit committees, or reviews of independent risk management's "budgets, staffing, and systems," create new, substantive responsibility for boards, and conflate the role of boards with the role of management.

e. Maintain a Capable Board Composition and Governance Structure

The proposed guidance establishes supervisory expectations with respect to board composition, governance structure, and the assessment of strengths and weaknesses. These are inherently internal functions, separate from the board's core oversight responsibilities. These functions are already well-regulated by SEC regulations, stock exchange listing requirements, and the board's fiduciary duties to shareholders established in state law. CCMC believes the establishment of Federal Reserve supervisory expectations with respect to these functions is unnecessary and unjustified.

Furthermore, the proposed text grants excessive and unworkable discretion to examiners and supervisory staff. For example, it is unclear how supervisors would determine whether there is sufficient "diversity of skills, knowledge, experience, and perspectives" among board members, or when it would be "appropriate" to engage third-party advisors or consultants.

f. <u>Review of Existing Expectations and Revision of SR 13-13/CA 13-10</u>

CCMC supports the Federal Reserve's ongoing review of existing supervisory expectations for boards as set forth in Supervision and Regulation letters, Federal Reserve regulations, and interagency guidance. Many of the principles identified above should inform this review. Specifically, the Federal Reserve should work to avoid a "one-size-fits-all" approach, overly prescriptive requirements, and expectations that conflate the roles of the board and senior management.

CCMC also support changes to SR letter 13-13/CA letter 13-10, establishing that Federal Reserve examiners and supervisory staff would only direct certain supervisory findings to the board for corrective action when the board needs to address its corporate governance responsibilities or when senior management fails to take appropriate remedial action. This policy will allow board to focus on their core oversight responsibilities and promote safety and soundness.

Conclusion

CCMC appreciates the opportunity to engage the Federal Reserve on this important matter. As stated above, we believe that strong corporate governance policies are critical to the long-term performance of banking institutions, as they are for organizations of any industry. However, supervisory guidance must not be overly prescriptive or unintentionally create new substantive requirements. We urge the Federal Reserve to carefully revise the proposed text with these considerations in mind.

Sincerely,

Tom Quaadman