



February 9, 2024

*Via Electronic Mail*

Federal Deposit Insurance Corporation  
550 17th Street, NW  
Washington, DC 20429  
Attention: James P. Sheesley, Assistant Executive Secretary  
RIN 3064-AF94

Re: Notice of Proposed Rulemaking and Issuance of Guidelines: Guidelines Establishing Standards for Corporate Governance and Risk Management for Covered Institutions With Total Consolidated Assets of \$10 Billion or More (RIN 3064-AF94)

Ladies and Gentlemen:

The Bank Policy Institute<sup>1</sup> and the American Association of Bank Directors<sup>2</sup> are writing to oppose the Federal Deposit Insurance Corporation's October 11, 2023 notice of proposed rulemaking and issuance of guidelines entitled *Guidelines Establishing Standards for*

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<sup>1</sup> BPI is a nonpartisan public policy, research and advocacy group that represents universal banks, regional banks, and the major foreign banks doing business in the United States. The Institute produces academic research and analysis on regulatory and monetary policy topics, analyzes and comments on proposed regulations, and represents the financial services industry with respect to cybersecurity, fraud, and other information security issues.

<sup>2</sup> AABD is a non-profit banking trade association supporting individual bank director advocacy, information, and training needs.

*Corporate Governance and Risk Management for Covered Institutions With Total Consolidated Assets of \$10 Billion or More.*<sup>3</sup>

We recognize the importance of corporate and risk governance structures and how they further safety and soundness at covered institutions.<sup>4</sup> The proposal, however, would create obstacles to the prudential management and performance of covered institutions. The proposal fails to recognize that its dictates are inconsistent with widely followed corporate governance practices, and ignores the need to tailor governance practices to the size, complexity, risk profile and business model of the bank, rather than impose a one-size-fits-all set of rules. Further, contrary to the proposal’s basic premise, the proposal is inconsistent with the guidance of other prudential regulators as well as state law that governs covered institutions. Finally, the proposal lacks any cost/benefit analysis, particularly with respect to its impact on the ability of covered institutions to attract and retain qualified directors. The proposal should be withdrawn and reissued only after correcting these fundamental deficiencies with respect to both process and substance.

***Executive Summary***

The comments that follow can be divided into two categories.<sup>5</sup> The first consists of what we consider fundamental flaws in the proposal. These flaws result from direct departures from existing corporate governance standards or the imposition of unrealistic and inappropriate responsibilities and risks on directors of covered institutions. These flaws include, for example:

- requiring at least a majority of bank directors to be independent not only from management, but also from the board of the parent company (contrary to well-established principles of “independence”);
- the requirements for a board of directors to “ensure” and “confirm” the bank’s safety and soundness, effective risk governance, and compliance

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<sup>3</sup> FDIC, Guidelines Establishing Standards for Corporate Governance and Risk Management for Covered Institutions With Total Consolidated Assets of \$10 Billion or More, 88 Fed. Reg. 70391 (proposed October 11, 2023).

<sup>4</sup> The proposal would apply to all insured state nonmember banks, state-licensed insured branches of foreign banks and insured state savings associations that are subject to Section 39 of the Federal Deposit Insurance Act with total consolidated assets of \$10 billion or more (“covered institutions”). References to “banks” in this letter should be read as references to covered institutions unless the context otherwise requires.

<sup>5</sup> Many of the comments in this letter draw on principles discussed in BPI’s Guiding Principles for Enhancing U.S. Banking Organization Corporate Governance (Jan. 2021) (“BPI Guiding Principles”), available at <https://bpi.com/wp-content/uploads/2021/01/BPI-Guiding-Principles-on-Enhancing-Banking-Organization-Corporate-Governance.pdf>.

with all laws and regulations (contrary to existing regulatory guidance and practices, and effectively impossible in practice);

- conflating the role of the board and the role of management, including by implying that bank boards may be expected to approve *all* a bank’s policies (contrary to existing regulatory guidance and practice);
- the requirement that directors consider the interests of multiple “stakeholders” (contrary to state law); and
- the requirement that the bank self-report all legal or regulatory violations to the board and governmental authorities with jurisdiction over the matter, including, in some cases, suspected violations (contrary to existing self-reporting regimes).

The second category consists of improvements that should be made in the final guidelines if the fundamental flaws can be cured. These improvements include, for example:

- clarifying that the results of board self-assessments are not subject to examination;
- clarifying that as long as a parent holding company’s risk management framework meets the FDIC’s guidelines, a bank should be able to leverage the aspects of the framework that appropriately address distinct bank-specific risks, rather than requiring a bank to recreate and duplicate functions, personnel, and systems at the bank level;
- affirming boards’ ability to rely, where appropriate, on information received from management and third-party experts;
- adopting certain additional technical comments and suggestions for improving the quality, coherence and clarity of the risk governance framework, including those relating to the “three lines of defense;” and
- providing for an appropriate transition period for any final guidelines.

## ***Introduction***

As an overview, the proposal appears to emanate from a basic misunderstanding of the role of a board of directors and would constitute a radical reinvention of their duties and role at banks and their holding companies. The proposal would redefine the criteria and what it means to be an independent director and expand the role of the board beyond its appropriate responsibilities under applicable state law, prior agency guidance and best practices. The flaws and fallacies in the proposal can be grouped into the following six broad categories.

*First*, the proposal, if implemented, would be counterproductive because the imposition of inappropriate and often unreasonable responsibilities on directors, and the related heightened risk of liability, would discourage qualified directors from serving on the boards of covered institutions. The proposal’s apparent failure to consider the adverse impact on director recruitment and retention—a core component of effective corporate governance—should in itself require a reissuance of the proposal to include an analysis of this key issue in the context of a cost-benefit analysis.

The proposal’s assignment of new responsibilities would conflate the role of the board with the role of management, which has been described by the Group of Thirty as “misguided and dangerous.”<sup>6</sup> Moreover, many of these responsibilities are inherently illogical.

One notable example of this defect is that a board “establish[] and approv[e] the policies that govern and guide the operations of the covered institution in accordance with its risk profile and as required by law and regulation.”<sup>7</sup> Because the policy approval requirement is not qualified by any standard, it could be interpreted as capturing all a covered institution’s policies, which are voluminous, extensive, and detailed even for smaller banking institutions. With very few, if any, exceptions, it is management, rather than the board, that “establishes” policies. Even with respect to approvals, the board “approves” only major policies.

*Second*, the proposal would impose director eligibility requirements that are poorly designed to fit with the realities of operating a bank and would significantly reduce the pool of qualified directors. Of particular concern is the proposal’s requirement that a majority of bank directors be independent from *both* management and the board of the parent company. This requirement would force substantial board turnover in light of the current board composition at many covered institutions. Banking organizations often employ a fully or largely overlapping board structure, with the encouragement of the banking agencies, to support cohesive and efficient decision-making and to help provide directors with a holistic understanding of the institutions’ businesses and enterprise risk management frameworks. This independent/independent requirement would therefore force many banks to engage in a major reconfiguration of their boards and introduce risks associated with significant disruptions in board continuity.

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<sup>6</sup> Group of Thirty, *Toward Effective Governance of Financial Institutions* (2012), *available at* [https://group30.org/images/uploads/publications/G30\\_TowardEffectiveGovernance.pdf](https://group30.org/images/uploads/publications/G30_TowardEffectiveGovernance.pdf), at 19–20 (“Well-functioning boards scrupulously discharge the following 10 essential tasks: . . . Respect the distinction between the board’s responsibilities for direction setting, oversight, and control, and management’s responsibilities to run the business. *It is misguided and dangerous to conflate the responsibilities of management with those of the board.*”) (emphasis added).

<sup>7</sup> Proposal, 88 Fed. Reg. at 70405.

*Third*, although the FDIC asserts that the proposal is “intended to be generally consistent with the goals” of the Office of the Comptroller of the Currency and the Board of Governors of the Federal Reserve System “communicated through the [agencies’] published issuances,”<sup>8</sup> the proposal is more expansive and prescriptive than the OCC guidelines and Federal Reserve guidance, as described throughout this letter. It would apply to substantially smaller banks—the OCC’s Heightened Standards and the Federal Reserve’s Regulation YY apply to organizations with \$50 billion or more in assets, as compared to the \$10 billion asset threshold in the proposal.<sup>9</sup> Indeed, the proposal maintains that it is designed to “codify the FDIC’s expectations,”<sup>10</sup> but it is inconsistent with, and sometimes even reverses, previous FDIC guidance. For example, the proposal provides that each director should “confirm” that the institution operates “in compliance with *all* laws and regulations.”<sup>11</sup> This requirement is both unrealistic and inconsistent with a board’s duty of oversight. More realistically, and generally consistent with a board’s duty of oversight, the FDIC’s current guidance acknowledges that “[b]oard members cannot be expected to be personally knowledgeable of all laws and regulations, but they should ensure that compliance with all laws and regulations receives high priority.”<sup>12</sup>

*Fourth*, the proposal contradicts well-established corporate governance principles that already apply to covered institutions under the laws of the chartering states that govern covered institutions and their parent companies. A key example is the proposal going beyond state law relating to a board’s constituency by establishing a requirement that boards of covered institutions consider the interests of multiple stakeholders, including the FDIC itself.<sup>13</sup> Inconsistencies with governance principles established by governing state law would cause confusion, create contradicting obligations for boards of directors, and raise complicated preemption questions. The proposal is fatally defective because it is inconsistent with these established governance principles.

*Fifth*, the proposal would impose a “one-size fits all” prescriptive approach, as opposed to enabling the directors to tailor governance practices to the size, complexity, risk

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<sup>8</sup> Proposal, 88 Fed. Reg. at 70393.

<sup>9</sup> Proposal, 88 Fed. Reg. at 70392; *see* 12 C.F.R. pt. 30, app. D, para. I.A.; 12 C.F.R. § 252.22.

<sup>10</sup> Proposal, 88 Fed. Reg. at 70398.

<sup>11</sup> Proposal, 88 Fed. Reg. at 70404 (emphasis added).

<sup>12</sup> FDIC, Risk Management Manual of Examination Policies § 4.1 (Mar. 2022), at 4.1-5.

<sup>13</sup> Proposal, 88 Fed. Reg. at 70404 (“The board, in supervising the covered institution, should consider the interests of *all its stakeholders*, including shareholders, depositors, creditors, customers, regulators, and the public.”) (emphasis added).

profile and business model of the bank. This approach deprives both boards and examiners of judgment and discretion, as any final guidelines would almost certainly be read by examiners as a binding requirement for which ongoing compliance must be documented and confirmed.

*Sixth*, the “poor corporate governance and risk management practices” that contributed to the bank failures in 2023 are not addressed in the proposal. The deficiencies in those cases were not the processes and formats prescribed by the proposal, but insufficient focus on core financial conditions and certain key risks that threatened the financial integrity of the banks that failed combined with too much focus on non-financial risk management and associated processes.<sup>14</sup>

The FDIC candidly acknowledges that it has not provided any quantitative analysis or support for its broad statement that the proposal would “benefit covered institutions by reducing the likelihood and magnitude of losses and the likelihood of failure.”<sup>15</sup> This absence of a cost-benefit analysis is particularly glaring in view of the extensive studies conducted by the FDIC and other government agencies on recent bank failures. The proposal fails to draw any linkage, and we believe there is none, between those failures and such requirements as an independent/independent board, establishment of a requirement for knowledge of all laws and regulations and reporting of suspected violations.

All the above concerns are especially acute because, as described below, the proposal is explicitly designed to facilitate the FDIC’s ability to take action against covered institutions when the FDIC concludes that a covered institution has not adhered to the final guidelines.

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<sup>14</sup> Jeremy Newell and Pat Parkinson, *A Failure of (Self-) Examination: A Thorough Review of SVB’s Exam Reports Yields Conclusions Very Different From Those in the Fed’s Self Assessment*, BPI Blog (May 8, 2023), <https://bpi.com/a-failure-of-self-examination-a-thorough-review-of-svbs-exam-reports-yields-conclusions-very-different-from-those-in-the-feds-self-assessment/> (last visited February 9, 2024) (“As the facts and timeline set forth in the Federal Reserve’s report make clear, the weaknesses that caused SVB’s demise were neither obscure nor complicated – SVB accumulated significant interest rate risk in its government securities portfolio that called into question its solvency, was reliant on large uninsured deposits collected from a single business sector for funding, and lacked an adequate liquidity strategy to survive a run on those deposits once questions about its solvency concerns became pronounced. . . . *Fed examiners appear to have been largely focused on nonfinancial risks, governance structures and compliance processes and procedures that were only weakly and indirectly related to its actual financial condition and safety and soundness.*”) (emphasis added).

<sup>15</sup> Proposal, 88 Fed. Reg. at 70398.

## *Analysis*

At the outset, the proposal fails to meet the requirements of the Administrative Procedure Act (the “APA”). The “guidelines” have the force and effect of law, because failure to meet its standards may lead to a requirement that a covered institution submit a safety and soundness plan under 12 U.S.C. § 1831p-1(e)(1)(A)(ii), noncompliance with which would lead to issuance of an order under part 308 of the FDIC’s regulations.<sup>16</sup> The guidelines may be set aside to the extent they were enacted in a manner that was “arbitrary, capricious, an abuse of discretion, or otherwise not in accordance with law.”<sup>17</sup> Under the APA, the proposal must be based on an examination of the relevant data and the FDIC must articulate a satisfactory explanation for its proposal that shows a rational connection between the facts found and the proposal.<sup>18</sup> It is also well established that courts may set aside an agency action under the APA if the agency has “entirely failed to consider an important aspect of the problem.”<sup>19</sup>

Further, under Section 302 of the Riegle Community Development and Regulatory Improvement Act, the FDIC must assess “any administrative burdens” that would be imposed by “new regulations that impose additional reporting, disclosure, or other requirements on insured depository institutions” along with “the benefits of such regulations.”<sup>20</sup>

As discussed below, however, the proposal fails in multiple respects to meet this fundamental APA test. There is no attempt to provide even a qualitative evaluation of the proposal’s costs or potential adverse consequences, in particular in terms of the negative impact on recruitment and retention of qualified directors. The proposal should be withdrawn and, if reissued, should address these fundamental deficiencies.

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<sup>16</sup> See, e.g., *Nat’l Min. Ass’n v. McCarthy*, 758 F.3d 243, 251 (D.C. Cir. 2014) (“[a]n agency action that purports to impose legally binding obligations or prohibitions on regulated parties—and that would be the basis for an enforcement action for violations of those obligations or requirements—is a legislative rule”).

<sup>17</sup> 5 U.S.C. § 706(2).

<sup>18</sup> See *Motor Vehicle Mfrs. Ass’n of U.S., Inc. v. State Farm Mut. Auto. Ins. Co.*, 463 U.S. 29, 43 (1983).

<sup>19</sup> *State Farm*, 463 U.S. at 43.

<sup>20</sup> 12 U.S.C. § 4802(a).

## **I. Numerous Aspects of the Proposal Undermine Sound Corporate Governance and Risk Management at Covered Institutions.**

The proposal would fundamentally alter the responsibilities of boards of directors by imposing overly prescriptive requirements or unrealistic expectations on boards, inappropriately requiring directors to undertake certain responsibilities, or contravening directors' fiduciary obligations under governing state law. Those aspects of the proposal should be eliminated. These concerns are discussed below.

### *A. Need for a Review of Impact on Bank Directors.*

A critical component of effective corporate governance is a highly qualified and engaged board of directors. Unduly burdensome requirements, or standards that create greater risk of liability for directors of covered institutions than for other companies, discourage capable directors from serving, or continuing to serve, on covered institution boards.<sup>21</sup> As we discuss below, there are numerous aspects of the proposal that would discourage, or even directly prevent, qualified directors from serving on the boards of covered institutions. The impact of this proposal on director recruitment and retention would be particularly acute because covered institutions compete for qualified directors with commercial entities that are not subject to these supervisory requirements.

The proposal does not take into account this essential issue, which undermines the entire proposal and should mandate its reconsideration. As it stands, there is a fundamental gap in the requisite analysis of the costs and burdens for covered institutions.<sup>22</sup> Prior to any reissuance of the proposal, the FDIC should conduct a thorough review of existing responsibilities imposed on bank boards of directors by regulation and supervisory expectations, consistent with the Federal Reserve's thorough review and director engagement process conducted in advance of and following its issuing board effectiveness guidance for bank holding company directors,<sup>23</sup> as well as by state law. The results of the review should be made public so

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<sup>21</sup> Phil Hall, *Key Considerations for Building Successful Bank Boards*, ABA Banking Journal (June 26, 2015), available at <https://bankingjournal.aba.com/2015/06/key-considerations-for-building-successful-bank-boards> (quoting interviewees at consulting groups CCG Catalyst Consulting Group and Meridian Compensation Partners) (“People used to think that a board position was a position of honor and status . . . . Now, not everyone is lining up to take on that responsibility. We see and hear banks are having trouble attracting board members. It is tougher and tougher out there to find the right professionals.”); *id.* (“Now, it is more risk- and time-intensive to be on a [bank] board . . . . The risk alone is driving away a lot of good candidates.”).

<sup>22</sup> See 12 U.S. Code § 4802(a)(1).

<sup>23</sup> Federal Reserve Board, Supervisory Expectations for Boards of Directors, 82 Fed. Reg. 37219 (Aug. 9, 2017).



that the FDIC’s expectations for bank boards are based on a published rationale that is clear and consistent. Such a review would also help ensure that the FDIC’s expectations do not impose unnecessary burdens on bank directors (which could distract boards from strategic and key risk analysis that are fundamental to prudent oversight), and do not discourage capable directors from serving on bank boards.

*B. The proposal requires directors to “ensure” and “confirm” safety and soundness, effective risk governance, and compliance with “all” laws.*

The proposal repeatedly uses “ensure” and “confirm” to describe board responsibilities. For example, the board must “confirm” that the covered institution operates in a safe and sound manner and in compliance with all laws and regulations, “ensure” the bank’s strategic plan is consistent with policies the board has approved, “ensure” management corrects any deficiencies that auditors or examiners identify in a timely manner, etc. Unless the term “ensure” is defined to mean something other than its normally accepted definition of “making certain,” *i.e.*, a guarantee,<sup>24</sup> the FDIC is effectively imposing a strict liability standard that is inconsistent with the responsibilities of the board under long-standing corporate governance standards. Even if the FDIC may not have intended such a standard, there is a very real concern that the use of words like “ensure” and “confirm” could lead to such a result. This risk is magnified because of the multiple novel obligations, discussed below, that the proposal would impose on directors of covered institutions. Such a regime would make it significantly more difficult for covered institutions to recruit the most qualified directors and discourage incumbent directors from standing for re-election, thus undermining the sound corporate governance of covered institutions.

To be consistent with well-established law and guidance on the role of the board of directors, including guidance from the other federal bank regulatory agencies and past guidance of the FDIC,<sup>25</sup> and to avoid these consequences, any final guidelines should eliminate the terms “ensure,” “confirm,” and similar language that could be construed as imposing on board members strict liability for the success of the bank, and instead use language that is consistent with the directors’ core oversight function. Similarly, and to avoid a conflation of the respective roles of the board and management, the proposal should be revised throughout to use the verbs “oversee,” and, where appropriate, “approve” or “review” (which are consistent with

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<sup>24</sup> Ensure is defined as “to make certain the occurrence or arrival of (an event), or the attainment of (a result).” *Ensure*, Oxford English Dictionary Online, <https://www.oed.com/search/dictionary/?scope=Entries&q=ensure> (last visited February 9, 2024).

<sup>25</sup> *Infra* note 65.

the board’s oversight role) rather than “establish,” “set,” or “select,” which are the roles of management.

To take a key example, the proposal contradicts existing FDIC guidance by providing that each director should “confirm” that the institution operates “in compliance with all laws and regulations.”<sup>26</sup> Banking institutions are subject to a uniquely complex web of laws, and the banking agencies have innumerable regulations—with many thousands of discrete requirements. How is a director supposed to “confirm” compliance with each of them, particularly as many of these laws and regulations involve complicated and often subjective judgments based on a unique set of facts and circumstances? Take, for example, 12 C.F.R. § 339.6, which requires a bank to use a standard flood hazard determination form developed by FEMA when determining whether the building offered as collateral for a loan is located in a special flood hazard area. How is a director to “confirm” that the bank’s flood hazard determination form is consistent with FEMA standards other than, presumably, reviewing the form himself or herself? Would requiring a member of management to certify compliance to the director be sufficient in view of the penalties that have been imposed on numerous banks? Even in the latter case, it would be a full-time job to review the certifications if applied to all laws and regulations.

The responsibility of the board should be to take steps to become satisfied that management’s framework and process for compliance with applicable law is appropriate for the institution, oversee management’s implementation of and reporting on that framework and hold management accountable for fulfilling their responsibilities under that framework.<sup>27</sup> This, more rational, expectation is consistent with recent FDIC guidance regarding the role of directors, which acknowledges that “[b]oard members cannot be expected to be personally knowledgeable of all laws and regulations, but they should ensure that compliance with all laws and regulations

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<sup>26</sup> Proposal, 88 Fed. Reg. at 70404.

<sup>27</sup> OCC, Comptroller’s Handbook—Safety and Soundness—Corporate and Risk Governance (July 2019), at 15 (“Board *oversight* is critical to maintaining the bank’s operations in a safe and sound manner and *the bank’s compliance with laws and regulations*. . . . To fulfill its responsibilities, the board *relies on senior management to oversee the key decisions and management to carry out the bank’s day-to-day activities*.”) (emphasis added); OCC, Comptroller’s Handbook—Safety and Soundness—Corporate and Risk Governance (July 2019), at 49 (“The board should *oversee* the bank’s [compliance management system]. For larger, more complex banks, the board should *receive periodic reports* on the bank’s state of compliance. The board is responsible for *establishing a culture* that places a high priority on compliance and *holds management accountable*. . . . Management is responsible for the timely correction of deficiencies found by compliance personnel, risk managers, internal and external auditors, and regulators. Management is responsible for implementing processes that promptly escalate material issues to senior management and the board.”) (emphasis added).

receives high priority.”<sup>28</sup> The board’s role is one of supervision; execution is the responsibility of management. Responsible individuals are unlikely to subject themselves to the substantial risk created by the proposal’s expanded standard for directors at covered institutions.

In addition, in light of the board’s oversight role and consistent with state law, any final guidelines should reflect and protect boards’ ability to rely, where appropriate, on information received from management and third-party experts.<sup>29</sup> The OCC’s Heightened Standards, for example, explicitly provide that “the board of directors may rely on risk assessments and reports prepared by independent risk management and internal audit . . . .”<sup>30</sup> The OCC explains that “[s]ome boards of directors periodically engage third-party experts to assist them in understanding risks and issues and to make recommendations to strengthen board and bank practices. Although the Guidelines focus on independent risk management and internal audit, they do not prohibit boards of directors from engaging third-party experts to also assist

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<sup>28</sup> FDIC, Risk Management Manual of Examination Policies § 4.1 (Mar. 2022), at 4.1-5. Although we do not believe “ensure” is the appropriate standard, we agree with the FDIC’s existing guidance that directors cannot be personally knowledgeable of all laws and regulations but should reinforce and communicate the priority of compliance with laws and regulations within their organizations and oversee the risk management and internal control functions.

<sup>29</sup> See, e.g., Model Bus. Corp. Act § 8.30(f) (Am. Bar Ass’n 2023) (“A director is entitled to rely . . . on: (1) one or more officers or employees of the corporation whom the director reasonably believes to be reliable and competent in the functions performed or the information, opinions, reports or statements provided; (2) legal counsel, public accountants, or other persons retained by the corporation as to matters involving skills or expertise the director reasonably believes are matters (i) within the particular person’s professional or expert competence, or (ii) as to which the particular person merits confidence; or (3) a board committee of which the director is not a member if the director reasonably believes the committee merits confidence.”); Del. Code. Ann. tit. 8, § 141(e) (“A member of the board of directors, or a member of any committee designated by the board of directors, shall, in the performance of such member’s duties, *be fully protected* in relying in good faith upon the records of the corporation and upon such information, opinions, reports or statements presented to the corporation by any of the corporation’s officers or employees, or committees of the board of directors, or by any other person as to matters the member reasonably believes are within such other person’s professional or expert competence and who has been selected with reasonable care by or on behalf of the corporation.”) (emphasis added); see also *Cirillo Family Trust v. Moezinia*, 2018 WL 3388398 at \*12 (Del. Ch. July 11, 2018), *aff’d*, *Cirillo Family Trust v. Moezinia*, 220 A.3d 912 (Del. 2019) (“Delaware law *statutorily* encourages directors to rely on experts, including legal counsel, to inform themselves and properly discharge their fiduciary duties.”).

<sup>30</sup> 12 C.F.R. pt. 30, app. D, para. III.B.

them in carrying out their duties.”<sup>31</sup> The Federal Reserve’s supervisory guidance provides “[a]n effective board also has the capacity to engage third-party advisors and consultants, when appropriate, to supplement the board’s knowledge, expertise, and experience and support the board in making sound, well-informed decisions.”<sup>32</sup> Any final guidelines should include a similar standard to affirm for directors of covered institutions that they may reasonably rely on reports and advice provided by management and third-party experts in carrying out their oversight responsibilities.

C. *The proposal requires directors to consider the interests of multiple “stakeholders.”*

The proposal would create the obligation for directors to consider interests of multiple “stakeholders” or constituencies, including those of depositors, creditors, customers, regulators, and the public,<sup>33</sup> going beyond a fundamental and longstanding corporate governance principle, derived from state law, pursuant to which consideration of stakeholders other than shareholders is generally, at most, permissive.<sup>34</sup> In view of this inconsistency with state law, this

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<sup>31</sup> OCC, Guidelines Establishing Heightened Standards for Certain Large Insured National Banks, Insured Federal Savings Associations, and Insured Federal Branches, 79 Fed. Reg. 54518, 54537 (Sept. 11, 2014).

<sup>32</sup> Federal Reserve, SR 21-3, Supervisory Guidance on Board of Directors’ Effectiveness (Feb. 2021), at 7.

<sup>33</sup> Proposal, 88 Fed. Reg. at 70404.

<sup>34</sup> For example, Connecticut, which at one time had a constituency provision that arguably mandated consideration of non-shareholder interests, deliberately amended the state statute in 2010 to have an unambiguously permissive standard. Connecticut Judiciary Committee Joint Favorable Report, An Act Concerning the Connecticut Business Corporation, HB-5530 (Mar. 26, 2010), available at <https://www.cga.ct.gov/2010/JFR/H/2010HB-05530-R00JUD-JFR.htm> (“Connecticut is the only state that *requires* rather than *permits* directors to consider each of these other constituencies. This imposes a burden on directors of Connecticut corporations that directors of corporations organized under other state laws do not face.”) (emphasis in original). Compare Conn. Gen. Stat. § 33-756(d) (2009) (“[A] director of a corporation . . . shall consider, in determining what he reasonably believes to be in the best interests of the corporation, (1) the long-term as well as the short-term interests of the corporation, (2) the interests of the shareholders, long-term as well as short-term, including the possibility that those interests may be best served by the continued independence of the corporation, (3) the interests of the corporation’s employees, customers, creditors and suppliers, and (4) community and societal considerations including those of any community in which any office or other facility of the corporation is located.”) with Conn. Gen. Stat. § 33-756(g) (2022) (“[A] director of a corporation . . . may consider, in determining what the director reasonably believes to be in the best interests of the corporation . . .”).

mandatory multiple constituency standard is not found in the comparable guidelines or regulations of the other federal banking agencies. It will create conflict, uncertainty and complexity for decisions made by the board of a covered institution.

The corporate governance regimes in all 50 states provide that directors owe fiduciary duties to the corporation and its shareholders.<sup>35</sup> The scope and formulation of these duties—including as to when, and to what extent, directors may consider the interests of stakeholders other than shareholders—is a matter of state law.<sup>36</sup>

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<sup>35</sup> See, e.g., Model Bus. Corp. Act § 8.30(a) (Am. Bar Ass’n 2023) (“Each member of the board of directors, when discharging the duties of a director, shall act: (i) in good faith, and (ii) in a manner the director reasonably believes to be in the best interests of the corporation.”); *id.* cmt. 1 (“The phrase ‘best interests of the corporation’ is key to an understanding of a director’s duties. The term ‘corporation’ is a surrogate for the business enterprise as well as *a frame of reference encompassing the shareholder body.*”) (emphasis added); *Revlon, Inc. v. MacAndrews & Forbes Holdings, Inc.*, 506 A.2d 173, 179 (Del. 1986) (“In discharging [the board’s] function the directors owe fiduciary duties of care and loyalty to the corporation and its shareholders.”) (internal citations omitted).

<sup>36</sup> In Delaware, directors are required to consider the best interests of shareholders, and consideration of non-shareholder stakeholders is permitted only if such consideration ultimately promotes shareholder value. See, e.g., *Revlon*, at 182 (“A board may have regard for various constituencies in discharging its responsibilities, provided there are rationally related benefits accruing to the stockholders.”); *Kahn v. Sullivan*, 594 A.2d 48, 62 (Del. 1991) (affirming the Court of Chancery’s decision that it was fair to shareholders for a corporation to include a charitable donation in a settlement agreement) (“[T]he Court of Chancery found that Occidental would, in fact, receive an economic benefit in the form of good will from the charitable donation to the Museum proposal. It also found that Occidental would derive an economic benefit from being able to utilize the Museum, adjacent to its corporate headquarters, in the promotion of its business”); Leo E. Strine, Jr., “The Dangers of Denial: The Need for a Clear-Eyed Understanding of the Power and Accountability Structure Established by the Delaware General Corporation Law,” 50 *Wake Forest Law Review* 761, 768 (2015) (“[A] clear-eyed look at the law of corporations in Delaware reveals that, within the limits of their discretion, directors must make stockholder welfare their sole end, and that other interests may be taken into consideration only as a means of promoting stockholder welfare.”). A number of other states allow the consideration of non-shareholder interests more directly. See, e.g., Fla. Stat. Ann. § 607.0830(6) (“In discharging board or board committee duties, a director may consider such factors as the director deems relevant, including the long-term prospects and interests of the corporation and its shareholders, and the social, economic, legal, or other effects of any action on the employees, suppliers, customers of the corporation or its subsidiaries, the communities and society in which the corporation or its subsidiaries operate, and the economy of the state and the nation.”); Idaho Code § 30-1702 (“In discharging the duties of the position of director of an issuing public corporation, a director, in considering the best interests of the corporation, shall consider the long-term as well as the short-term interests of the corporation and its shareholders including the possibility that these interests may be best served by the continued independence of the corporation. In addition,

A constituency provision that mandates consideration of non-shareholder interests creates a serious dilemma for boards—particularly boards of institutions organized in jurisdictions where consideration of stakeholder interests is permissible only if such consideration ultimately promotes shareholder value. The FDIC must recognize that the proposal’s mandatory constituency provision would conflict with the laws of the states in which covered institutions are chartered.<sup>37</sup> Further, there is no indication in the proposal as to how directors should weigh the various stakeholder interests. And, because this type of broadly applicable mandatory constituency provision is unique, we are not aware of any judicial precedent or other landmarks to guide decision-making. If a decision affects different constituencies differently, directors of covered institutions would be at risk of liability if a decision is favorable for shareholders but potentially unfavorable for one or more other constituencies (or vice versa).

The dilemma for directors is exacerbated by the proposal’s inclusion of “regulators” as a constituency that must be considered. Although bank boards should reinforce the importance of compliance with laws and regulations and maintaining constructive relationships with regulatory authorities, we have not identified any state banking or corporate statute in the United States that provides that the regulators, or any governmental agency, are a relevant (let alone mandatory) constituency. Accordingly, if a board were to consider the interests of the regulators, it would go beyond the law of its chartering authority; if the board did not consider the interests of the regulators, it would not comport with the FDIC’s standards under the proposal. The FDIC’s corporate governance guidelines should not place directors in such an

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a director may consider the interests of Idaho employees, suppliers, customers and communities in discharging his duties.”). However, as discussed below, we have not identified any state that suggests that the permissive stakeholders include regulators. Moreover, some constituency statutes only apply in specified contexts, usually a board’s review of a change of control transaction. *See, e.g.*, Or. Rev. Stat. Ann. § 60.357(5) (2022) (permissive constituency statute applicable to directors when “evaluating any offer of another party to make a tender or exchange offer for any equity security of the corporation, or any proposal to merge or consolidate the corporation with another corporation or to purchase or otherwise acquire all or substantially all the properties and assets of the corporation”).

<sup>37</sup> Any argument that the FDIC could make to the effect that it has the power to preempt and override state law on matters of corporate governance, under a safety and soundness rubric, is of dubious provenance at best. At a minimum, it would require a convincing showing by the FDIC that state law developed over decades of experience produces unsafe and unsound practices. Any such argument would also contravene the FDIC’s own statement that the proposal is designed to be consistent with existing governance principles.

impossible position.<sup>38</sup> Of course, it is a remarkable concept that a U.S. company should be run to further the interests of a government agency.

In summary, the FDIC should eliminate this constituency provision entirely and leave the important and extensively litigated question of directors' fiduciary duties to settled state law.

*D. The proposal inappropriately discourages directors from considering the interests of the parent holding company.*

The proposal creates a dichotomy between a covered institution and its parent, which is typically the covered institution's sole shareholder. Specifically, the proposal provides "the key component [of good corporate governance is] an active and involved board protecting the interests of the institution *rather* than the interests of the parent."<sup>39</sup>

As described above, this dichotomy contravenes a core principle of state corporate law that directors have a fiduciary duty to seek to advance the best interests of the company's shareholders.<sup>40</sup> In the case of wholly owned subsidiaries, that means the interests of the parent entity.<sup>41</sup> The proposal, however, exposes directors to risk of an adverse action by the FDIC if they consider the interests of the parent, despite owing fiduciary duties to that parent under state law. That creates a further impossible dilemma for bank directors.

As a result, the proposal's language suggesting that directors should disregard the interests of the parent entity should be removed.

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<sup>38</sup> The proposal also does not indicate how a board would ascertain the interests of regulators, which may differ across agencies and over time.

<sup>39</sup> Proposal, 88 Fed. Reg. at 70393 (emphasis added).

<sup>40</sup> *Supra* note 35.

<sup>41</sup> *See, e.g., Quadrant Structured Products Co. v. Vertin*, 102 A.3d 155, 184 (Del. Ch. 2014) ("When a controller owns 100% of a corporation's equity and the subsidiary is solvent, the interests of the corporation and its fiduciaries are fully aligned with those of the controller. The fiduciary duties of the directors and officers require that the subsidiary be managed for the benefit of the controller . . . ."); *Anadarko Petroleum Corp. v. Panhandle E. Corp.*, 545 A.2d 1171, 1174 (Del. 1988) ("in a parent and wholly-owned subsidiary context, the directors of the subsidiary are obligated only to manage the affairs of the subsidiary in the best interests of the parent and its shareholders"); *Aviall, Inc v. Ryder Sys., Inc.*, 913 F. Supp. 826, 832 (S.D.N.Y. 1996) (applying New York law) ("When one company wholly owns another, the directors of the parent and the subsidiary are obligated to manage the affairs of the subsidiary in the best interests only of the parent and its shareholders."), *aff'd*, 110 F.3d 892, 896 (2d Cir. 1997).

*E. The proposal introduces a novel definition of director independence.*

The proposal would require a majority of bank directors to be independent not only from management, but also from *the board of the parent company*.<sup>42</sup> This independent/independent requirement is a marked departure from both the formal and informal guidance of the federal banking regulators,<sup>43</sup> common bank practice, and corporate law requirements.<sup>44</sup> As a result, the proposal creates a significant departure and inconsistency in respect of one of the most fundamental elements of corporate governance—board composition. Many banks have, with sound reasons and full regulatory support, maintained nearly identical boards of directors at the bank and holding company.

To support this marked change, the proposal refers to the three failures of large banks in early 2023.<sup>45</sup> None of these failures provides even the slightest support for the independent/independent requirement. *Two of the three failed banks did not even have a holding company*.<sup>46</sup> We are unaware of any assertion that undue influence by the parent was a factor in

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<sup>42</sup> Proposal, 88 Fed. Reg. at 70405.

<sup>43</sup> See, e.g., Valentine V. Craig, *The Changing Corporate Governance Environment: Implications for the Banking Industry*, 16 FDIC Banking Rev. 121, 131 (2004) (“Directors are also permitted to serve both on the board of the holding company and on the board of its bank. For the most part, the FDIC has not found these interlocking directorships a serious governance problem.”).

<sup>44</sup> An independent/independent standard deviates from, and is far more prescriptive than, the director independence requirements reflected in existing laws and standards, including the OCC’s Heightened Standards, the FDIC’s part 363, the Federal Reserve’s Regulation YY, the SEC’s rules and listing company standards adopted by national exchanges. See, e.g., 12 C.F.R. pt. 30, app. D, para. III.D; 12 C.F.R. § 363.5 (providing that a majority of members of audit committees should be “independent of management of the institution,” not independent from the holding company board) (emphasis added); 12 C.F.R. § 252.22(a)(4); 12 C.F.R. § 252.33(a)(4); 17 C.F.R. § 240.10A-3(b)(1); NYSE Listed Company Manual, § 303A.02; *id.* cmt.1 (pointing out that “the concern [about independence] is independence from management”) (emphasis added); Nasdaq Equity Rules § 5605(a)(2), IM-5605.

<sup>45</sup> Proposal, 88 Fed. Reg. at 70391 n.3 (“The FDIC report on the failure of Signature Bank in 2023 found that the root cause of the failure was poor management without adequate risk management practices and controls. The institution’s management did not prioritize good corporate governance practices. . . . The Federal Reserve Board’s report on the failure of Silicon Valley Bank also identified governance and risk management failures that led to the failure.”).

<sup>46</sup> See FDIC, 2023-PR-73, FDIC’s Supervision of First Republic Bank (Sept. 2023), at 6 (“First Republic was a state non-member, commercial bank and trust company *with no holding company*”) (emphasis added); FDIC, 2023-PR-33, FDIC’s Supervision of Signature Bank (Apr.



the third. In fact, neither the Federal Reserve’s report on the supervision of Silicon Valley Bank, the very report cited by and relied upon by the FDIC in the proposal,<sup>47</sup> nor the material loss review report issued by the Office of the Inspector General of the Federal Reserve, makes any mention of undue influence by the parent as a contributing factor to the failure of the bank.<sup>48</sup>

There are persuasive reasons for commonality of bank and holding company directors that extend beyond the resultant efficiency. Banking organizations may often find that common directors at the bank and the holding company—an approach that has been encouraged by the banking agencies as a structure that facilitates enterprise-wide risk management—can support cohesive and efficient decision-making and help to provide directors with a holistic understanding of the institutions’ businesses and risk management frameworks.<sup>49</sup> The proposal would deprive covered institutions of this flexibility and its practical benefits.

The proposed requirement for independent/independent directors would not only supersede the judgment of the boards of banking organizations in designing effective board composition, but would force many banks to substantially reshape their boards. This would be highly disruptive and indeed threaten the corporate governance of the banks involved. If, for example, a bank had 12 directors and only two were independent of the holding company, the bank would need to replace five current directors (over 40% of the board) with new independent directors who are both qualified and willing to serve, eliminate a large number of the sitting

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2023), at 6 (“[Signature Bank] was publicly traded, *had no holding company* or principal shareholders, and had well-diversified ownership.”) (emphasis added).

<sup>47</sup> See Proposal, 88 Fed. Reg. at 70391 n.3.

<sup>48</sup> See Federal Reserve, Review of the Federal Reserve’s Supervision and Regulation of Silicon Valley Bank (Apr. 2023); Federal Reserve, Material Loss Review of Silicon Valley Bank (Sept. 2023), at 13–15.

<sup>49</sup> When the Federal Reserve considered imposing an independent/independent director requirement on the board of General Electric Capital Corporation, the 16 independent directors serving on the board of General Electric Company commented that “such a novel requirement would undermine a cardinal principle of good corporate governance that has held true over our collective years of service on GE’s Board and other boards—namely, the practical reality that, for a Board or Risk Committee to oversee a company like GE Capital effectively, its members must be bound together by shared fiduciary duties and a common mission of ensuring the safety and soundness of the enterprise.” Letter from W. Geoffrey Beattie et al., Indep. Dirs., Gen. Elec. Co., to Robert deV. Frierson, Sec’y, Federal Reserve (Feb. 2, 2015) (on file with the Federal Reserve), available at [https://www.federalreserve.gov/SECRS/2015/February/20150205/R-1503/R-1503\\_020215\\_129879\\_536678377188\\_1.pdf](https://www.federalreserve.gov/SECRS/2015/February/20150205/R-1503/R-1503_020215_129879_536678377188_1.pdf). Ultimately, the Federal Reserve declined to impose an independent/independent director requirement. Federal Reserve, Final Order Applying Enhanced Prudential Standards and Reporting Requirements to General Electric Capital Corporation, 80 Fed. Reg. 44111, 44116–17 (July 24, 2015).

directors, or some combination.<sup>50</sup> The loss of continuity would be unprecedented, even assuming that institutions are able to recruit and retain qualified replacement directors.

There is no suggestion in the proposal that the FDIC considered the massively disruptive impact of this independent/independent requirement or the extent of the available talent pool. If the 57 institutions directly affected by this requirement averaged five replacements, there would be an immediate and simultaneous need for almost 300 new directors. Having 57 banks simultaneously identifying and appointing almost 300 new qualified directors would be a highly disruptive undertaking under normal circumstances, even without the aspects of the proposal that will deter qualified individuals from serving on boards. In addition, a bank cannot simply appoint directors that have been forced to leave the board of another bank due to the independent/independent requirement, as those departing directors could still be serving on the board of the other bank's parent company, which could raise interlocks issues as well as other corporate governance considerations, such as concerns about director overload.

There is a vague exception to the "independent/independent" requirement in a footnote of the proposal, which is applicable if the holding company conducts "limited" (which is not defined) or no additional business operations outside the bank, and if the director is not a principal, member, director, officer or employee "of any other institution or holding company affiliates."<sup>51</sup> Without further elaboration, the relevance of this exception is unknowable.<sup>52</sup>

We assume the FDIC's concern with the service of directors on both boards is the potential for conflicts of interest. Critically, however, in the ordinary course, the interests of a bank and its holding company are aligned.<sup>53</sup> In the extraordinary cases when interests may

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<sup>50</sup> In addition, the phrase "at least a majority" could be read to suggest that the FDIC might expect a super-majority of the directors to be independent/independent (at least at larger banks). In that case, if a 12-person bank board had total overlap with the parent, it would be required to replace at least eight of the 12 directors to effectuate a super-majority standard.

<sup>51</sup> Proposal, 88 Fed. Reg. at 70405, n.45. Without clarification, the language could be read to exclude any director candidate that holds a position in a third party institution not affiliated with the bank.

<sup>52</sup> For example, in determining whether there are "limited" business operations outside the bank, will the FDIC reference the OCC's standard for determining whether the risk profiles of a holding company and subsidiary bank are "substantially the same," which provides an opportunity for institutions to seek an exception from the OCC if the quantitative test is not met? *See* 12 C.F.R. pt. 30, app. D, para. I.

<sup>53</sup> BPI Guiding Principles, at 24 ("Of course, directors who serve on both holding company and subsidiary bank boards should remain cognizant of the role in which they are acting at any particular time, and their responsibilities to the entity of which they are acting as a board member. In general, in business as usual and other circumstances, the 'source of strength' requirements of

diverge, existing laws and corporate governance practices, with which directors are well versed, address this concern. For example, when a conflict of interest in the exercise of a director’s duties to the two organizations arises, the organization can reconsider its board composition by forming a special committee of directors to take actions or even appoint new directors.<sup>54</sup>

To resolve the concern regarding conflicts of interest without imposing significant changes to governance structures that govern ordinary situations (*i.e.*, the vast majority of an organization’s operations), any final guidelines could provide, consistent with OCC guidelines, that “to the extent the bank’s independent directors are also members of the parent company’s board, the OCC would expect that such directors would consider the safety and soundness of the bank in decisions made by the parent company that impact the bank’s risk profile”<sup>55</sup> or, consistent with even more recent OCC guidance, that “a director who serves on the board of both the bank and its holding company must comply with the director’s fiduciary duties to the bank, including the duty of loyalty.”<sup>56</sup>

For these reasons, the proposal should be revised to remove the “independent/independent” concept. It has no legal or analytical basis. There is no one-size-fits-all approach to good corporate governance. The qualified directors and senior managers of banks who are familiar with their organizations should have the flexibility to determine the most suitable governance practices for the organization, including the composition of the board of directors. Any requirement regarding board composition in any final guidelines should be limited to the standard, consistent with the OCC’s Heightened Standards, that at least two directors of a covered institution be independent *of management*.<sup>57</sup>

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holding companies and the ‘safety and soundness’ considerations for banks create alignment of interests between the holding company board and the bank board and mitigate any potential conflict of interests.”) (internal citations omitted).

<sup>54</sup> See, e.g., *Flood v. Synutra Int’l, Inc.*, 195 A.3d 754, 756 (Del. 2018).

<sup>55</sup> 79 Fed. Reg. at 54538.

<sup>56</sup> OCC Director’s Book: Role of Directors for National Banks and Federal Savings Associations (Nov. 2020) (“OCC Director’s Book”), at 34; see also BPI Guiding Principles, at 5 (“In particular, the governance structure of a holding company organization should reflect the critical responsibility of the board of directors of the subsidiary bank to protect the safety and soundness of the bank.”).

<sup>57</sup> 12 C.F.R. pt. 30, app. D, para. III.D. We understand that the proposal would not impact the ability of a covered institution to have a board chair that is a member of management (*i.e.*, the CEO), which is a common governance practice. See, e.g., OCC Director’s Book, at 18 (discussing the two most common structures for board leadership—an independent chair and a chair that is also the CEO—and stating that “[b]oth structures can be equally effective”).

F. *Notwithstanding the board's oversight role, the proposal suggests that a board of directors is expected to approve all bank policies.*

The proposal would impose a range of specific responsibilities on boards of directors. One of the most notable examples is “establishing and approving the policies that govern and guide the operations of the covered institution in accordance with its risk profile and as required by law and regulation.”<sup>58</sup> The reference to “establish” alongside “approve” could be read to suggest the board of directors’ role includes the design or drafting of the institution’s policies, which is the job of management.<sup>59</sup> Even if the proposal were revised to remove the references to “establish,” the policy approval requirement is not qualified by any standard, and could be interpreted to capture all a covered institution’s policies, which are voluminous, extensive, and detailed even for smaller banking institutions.<sup>60</sup>

This requirement appears to underestimate significantly the number of bank policies that govern covered institutions (which can number in the hundreds or even thousands for larger banks) and the amount of time it would take for directors to review and approve, much less establish, all bank policies. Applicable law already provides for mandatory board approval of certain policies.<sup>61</sup> Beyond the policies that are required by applicable law to be approved by the board, the top-tier policies that merit board review or approval will depend on the nature, size, and complexity of the organization’s activities. For example, risk policies that do not fundamentally contribute to defining or managing the organization’s primary risk tolerances do not ordinarily warrant board attention or action unless the subject matter itself may be so essential to the safe and sound operation of the particular organization that such attention and

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<sup>58</sup> Proposal, 88 Fed. Reg. at 70405.

<sup>59</sup> For example, under the OCC’s Heightened Standards, it is the responsibility of the front line units to “*establish* and adhere to a set of written policies that include front line unit risk limits” and the responsibility of independent risk management to “*establish* and adhere to enterprise policies that include concentration risk limits.” 12 C.F.R. pt. 30, app. D, para. II.C (emphasis added). Also under the OCC’s Heightened Standards, the formal, written risk governance framework is “*designed* by independent risk management and *approved* by the board of directors or the board’s risk committee.” 12 C.F.R. pt. 30, app. D, para. II.A (emphasis added).

<sup>60</sup> If the FDIC intended to require approval of only the policies required to be approved by the board pursuant to law or regulation, that should be clarified.

<sup>61</sup> For example, the board must approve the bank’s policies establishing limits and standards for extensions of credit that are secured by liens on or interests in real estate, including loan portfolio diversification standards and prudent underwriting standards that are clear and measurable. 12 C.F.R. § 365.2.

action is considered necessary.<sup>62</sup> Beyond legal requirements, boards of directors and senior management exercise prudent judgment to identify the top-tier policies that merit board review or approval.<sup>63</sup> The remainder of policies—in many cases, more procedural in nature and for use in the day-to-day activities of the bank—can be established and approved appropriately at the management level.

The OCC removed from the final Heightened Standards a proposed requirement that the board or risk committee approve any material policies under the risk governance framework. Recognizing that approval of even material risk policies was a management rather than board responsibility, the OCC explained that it “did not intend to assign managerial responsibilities to the board of directors or its risk committee.”<sup>64</sup> As currently drafted, the requirement in the FDIC’s proposal is even broader than the proposed Heightened Standards requirement that the OCC declined to adopt.

Fundamentally, this requirement exemplifies the proposal’s transformation of a board’s core oversight function—which includes asking informed, probing questions of management, which at times has been referred to as “credible challenge” to management, and holding management accountable—into a management function in contravention of the appropriate role of the board pursuant to well-established corporate governance principles. The existing corporate governance regime includes principles, derived from an extensive, well-settled body of law and guidance,<sup>65</sup> on the allocation of the respective roles of the board of directors and management, which the proposal would fundamentally undermine.

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<sup>62</sup> BPI Guiding Principles, at 33.

<sup>63</sup> This approach is consistent with the Federal Reserve’s supervisory guidance, which provides that an “effective board reviews and approves *significant* policies, programs, and plans based on the firm’s strategy, risk appetite, risk management capacity, and structure.” Federal Reserve, SR 21-3, Supervisory Guidance on Board of Directors’ Effectiveness (Feb. 2021), at 3 (emphasis added).

<sup>64</sup> 79 Fed. Reg. at 54526 (Sep. 11, 2014).

<sup>65</sup> OCC Director’s Book, at 14–15 (“The board’s role in the governance of the bank is clearly distinct from management’s role. *The board is responsible for the overall direction and oversight of the bank—but is not responsible for managing the bank day-to-day.* The board should oversee and hold management accountable for meeting strategic objectives within the bank’s risk appetite.”) (emphasis added); Federal Reserve, SR 21-3, Supervisory Guidance on Board of Directors’ Effectiveness (Feb. 2021), at 2–7 (describing functions of an effective board, including to “set clear, aligned and consistent *direction* regarding the firm’s strategy and risk appetite” and “*oversee* and hold senior management accountable”) (emphasis added); FDIC, Risk Management Manual of Examination Policies § 4.1 (Mar. 2022), at 4.1-3 (“Directors are responsible for

Conflating the role of the board with the role of management is “misguided and dangerous.”<sup>66</sup> Any blurring of the distinction between the role of the board and the role of management would detract from effective governance by potentially reducing the board’s ability to perform its oversight role objectively, undercutting the authority of management, and creating uncertainty and confusion as to roles and responsibilities. It could effectively convert board service into a full-time job and thereby preclude numerous highly qualified individuals.

Therefore, the FDIC should remove the policy approval requirement from the proposal and rely instead on currently applicable legal requirements and sound bank governance practices that appropriately provide flexibility to boards of directors and senior management to determine the scope of policies that are subject to board approval.

*G. The proposal includes a requirement to escalate and self-report all legal or regulatory violations.*

The proposal would require a bank board to establish processes pursuant to which personnel in front line and independent risk management units would be expected to identify, document, and notify the CEO and the board’s audit and risk committees of *all* violations of law or regulation. The proposal would also require the covered institution to timely self-report *all* violations of law or regulation to the agency with jurisdiction. This requirement does not have any materiality standard, limitation of scope, or clarity on the timing of such reporting.<sup>67</sup>

*i. Internal escalation requirements*

With respect to internal escalation, banks are already subject to agency guidance and numerous other supervisory and enforcement policies that address the handling of legal and regulatory violations. In our experience, in practice, banks maintain issue management systems and related remediation processes to address potential violations of law and regulation or violations of policies and procedures, and escalated issue reporting provides a process for key issues to be reported to the board of directors (*e.g.*, the types of information—whether individual acts or patterns of activity—that should be brought to the attention of the board). A prescriptive internal escalation standard that effectively overrides the principles of supervisory guidance and mandates of state fiduciary obligations to establish a reporting process for legal or compliance matters should be removed.

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providing a clear framework of risk appetite, strategic focus, objectives and general policies within which executive officers operate and administer the bank’s affairs.”).

<sup>66</sup> *Supra* note 6.

<sup>67</sup> Proposal, 88 Fed. Reg. at 70409.

If the requirement to report internally violations of law or regulation remains in any final guidelines, it should only cover the escalation of known violations of laws or regulations that, in the reasonable judgment of management, may have a *material impact* on the bank’s safety and soundness. Banks are subject to an extensive scheme of laws and regulations, and “[d]ifferences of opinion can arise regarding the interpretation of [those] laws and regulations.”<sup>68</sup> Reporting to the most senior levels of the bank—the CEO and the board—all violations of law and regulation, regardless of materiality, would require substantial investment of bank resources with little, if any, corresponding benefit to safety and soundness—potentially diverting time, attention (including the time and attention of the CEO, board of directors, and the legal and compliance departments) and resources from the most critical issues facing a bank. For example, the requirement as drafted could be interpreted as requiring reporting to the CEO and board of directors for local zoning violations involving a single branch. Further, if examiners feel pressure to “hunt” for unreported violations, this will not only impair examiners’ ability to focus on key risks, but will also lead covered institutions to expend extraordinary resources investigating minor matters, determining whether those matters are in fact violations, having the second line of defense review those determinations, and presenting them to the board.

Any final guidelines should also remove any reference to “suspected” violations of laws and regulations. Although we agree that banks must be vigilant in monitoring compliance with laws and actively investigate potential issues, a mandatory escalation requirement applicable to all suspected violations of law could divert the focus and attention of the CEO and bank directors away from core issues of risk management, including the remediation of material compliance issues, and toward a multitude of matters, many of which will not rise to the level of a violation of law or regulation after further investigation. Further, covered institutions will struggle to determine when a violation is sufficiently “suspected” such that it should be escalated.

#### *ii. Mandatory external reporting requirements*

The final guidelines, if issued, should eliminate this unprecedented requirement. We are not aware of any required self-reporting regime of this unbounded scope, and the OCC’s Heightened Standards do not contain any requirement regarding self-reporting of legal or regulatory violations. Self-reporting has only been used when justified in specific contexts and pursuant to detailed statutory and regulatory requirements. And even in those contexts, complex issues associated with self-reporting continue to arise, such as the risk of exposing sensitive and confidential information to the public through, for example, civil action discovery.

We strongly believe that the final guidelines, if issued, should not include any requirement that banks self-report to governmental authorities violations of laws and regulations. The mandatory self-reporting requirement could be read as effectively establishing a novel and sweeping requirement to report violations by bank personnel, customers, or other third parties to relevant government offices and agencies.

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<sup>68</sup> FDIC, Risk Management Manual of Examination Policies § 4.5 (Feb. 2019), at 4.5-2.

First, although certain government agencies encourage regulated entities to self-report certain defined types of violations of law, we are unaware of any government agencies that mandate such sweeping self-reporting.

Second, a mandatory reporting regime is entirely divorced from, and potentially contrary to, the safety and soundness foundation of Section 39 of the Federal Deposit Insurance Act. A mandatory requirement to self-report all violations of laws and regulations forces a “violation” or “no violation” determination in areas that are often subject to interpretation or evolving facts. This could result in covered institutions drawing the line too conservatively and “underreporting,” or drawing the line too liberally and “overreporting.” With respect to the former, a formal reporting process pursuant to which a matter has to be documented as a suspected or known violation may have a chilling effect on what is conveyed to examiners-in-charge as events are evolving and before a formal investigation is completed or a determination has been made that a violation has occurred. The latter could inundate examiners with information and impair the ability of examiners, who have finite resources<sup>69</sup> and already receive reporting on key issues through issue management systems, to identify, focus on, and respond to key risks. In either case, the costs of a mandatory self-reporting requirement are not outweighed by any benefits.<sup>70</sup>

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<sup>69</sup> The FDIC has identified that resource challenges affected the timeliness and quality of examinations of at least one institution that failed in 2023. FDIC, 2023-PR-33, FDIC’s Supervision of Signature Bank (Apr. 2023), at 4 (“The FDIC experienced resource challenges with examination staff that affected the timeliness and quality of SBNY examinations.”). Resource constraints are not limited to the FDIC. For example, “[f]or the Federal Reserve System as a whole, resources did not grow with the banking industry. From 2016 to 2022, banking sector assets grew 37 percent (nominal terms), while FRS supervision headcount declined by 3 percent. . . . It is difficult to quantify the impact of this shift, but supervisory coverage of SVBFG declined while SVBFG was in the RBO portfolio. For SVBFG in particular, supervision resources declined despite the firm’s rapid growth and increased risk.” Federal Reserve, Review of the Federal Reserve’s Supervision and Regulation of Silicon Valley Bank (Apr. 2023), at 36.

<sup>70</sup> Further, numerous questions are raised by the proposed requirement. For example, it may not be clear in all cases which agency has “jurisdiction” over the applicable law or regulation. Does the FDIC always have jurisdiction as the principal federal regulator? Does the proposed requirement include only laws that are specific to banking, or all generally applicable laws? How will laws that are subject to a circuit split on interpretation be treated with respect to an institution that conducts business in multiple jurisdictions? As interpretations of laws evolve over time, will a reassessment of prior conduct be required? What is the standard for reporting—a determination that a violation has occurred, a finding that a violation is more likely than not, or some other standard?



*H. The board self-assessment requirement does not clarify that results are not subject to examination.*

The proposal provides that a bank board should conduct an annual self-assessment evaluating its effectiveness in meeting the standards of the final guidelines.<sup>71</sup> We agree that board self-assessments can be helpful in assessing board functioning. Indeed, boards perform self-assessments to improve their own functioning and oversight in the context of the institution's size, complexity, risk profile and business model. However, unless it is clear that examiners cannot review the results of those self-assessments, their value would be severely diminished.

Any final guidelines should provide explicitly that self-assessment results will not be reviewed by examiners due to the possible chilling effect on directors' candid self-evaluation. For this reason, the Federal Reserve proposed, but subsequently removed from its final supervisory guidance, a suggestion that the results of boards' regular self-assessments be provided to Federal Reserve examiners.<sup>72</sup> The FDIC should provide that a bank's confirmation to examination staff that the board has conducted the required self-assessment and a description of the self-assessment process will be sufficient to satisfy the final guidelines. If directors are concerned that results will be shared with regulators for purposes of evaluating compliance with the guidelines, it is likely to make director assessments less candid and useful, especially if directors are concerned that the results of the self-assessment could be taken out of context and used to support adverse supervisory findings. Assessments should encourage self-reflection to identify opportunities for improvement and not be used as evidence of noncompliance with any final guidelines. Other materials could be provided to examiners to provide insight into board functioning and compliance with the guidelines. These materials may include, as appropriate, board presentations, board resolutions, board minutes, annual proxy statements and other disclosure statements for publicly 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.

For these reasons, if final guidelines are issued, the FDIC should provide that the results of self-assessments will not be subject to review by examiners. If the topic of self-

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<sup>71</sup> Proposal, 88 Fed. Reg. at 70406.

<sup>72</sup> Federal Reserve, SR 21-3a, Overview of Comments on and Revisions to Proposed Guidance on Supervisory Expectations for Boards of Directors (Feb. 2021), at 1, *available at* <https://www.federalreserve.gov/supervisionreg/srletters/SR2103aCommentSummaryPublication.pdf> ("Commenters asserted that sharing the results of self-assessments would have a chilling effect on director honesty and candor, which would undermine the value of conducting self-assessments. Because examiners draw on a variety of information when assessing the effectiveness of board oversight, the Board agreed with commenters that providing the results of self-assessments was not needed.").

assessments is addressed, any final guidelines should acknowledge that different banks employ very different approaches and assessments are intended to be a tool available to boards to identify opportunities for improvement.

- I. *The proposal may not afford sufficient flexibility to individual banks regarding the relationship between the risk management frameworks of a bank and its parent holding company.*

The proposal would permit a covered institution that has a parent company to adopt and implement all or any part of its parent company's risk management program if the risk profiles of each entity are "substantially similar" and certain other conditions are met.<sup>73</sup> We support the fundamental concept underlying the proposal that an effective risk management framework should be (i) capable of distinguishing, identifying, and monitoring aggregate risk at the bank level, (ii) appropriately tailored to the bank's risk profile, and (iii) designed to provide for robust checks and balances to ensure the integrity of the bank's risk management process. In practice, such a framework should permit a bank's supervisors and examiners to identify the bank's risk profile, risk appetite statement and risk limits, and to understand how the bank meets the risk reporting requirements of the final guidelines.

However, achieving these underlying objectives through a "separate bank risk management framework" should not mean that a bank must recreate and duplicate at the bank level, with separate personnel and reporting systems, components of the holding company's risk management framework that appropriately address bank-specific risks. Today, many banks have personnel who perform risk management or related functions at both the holding company and the bank, as well as reporting systems and functions operated centrally at the holding company. In addition, where the holding company largely consists of the bank's assets, liabilities and activities, the need for distinct risk management frameworks for the bank and the holding company is obviously diminished or extinguished. Reduced to the core purpose, a risk framework should provide a mechanism through which all covered businesses carry out specific routines to establish appropriate risk appetites, risk governance and risk reporting procedures, and specific risk management processes to identify, measure, monitor, and respond to risks affecting both the individual business units and the enterprise as a whole. As described below, as long as a parent holding company's risk management framework meets the FDIC's guidelines, a

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<sup>73</sup> Proposal, 88 Fed. Reg. at 70406–07 (“[I]f the risk profiles of each entity are substantially similar, the covered institution may adopt and implement all or any part of its parent company’s risk management program that: 1. Satisfies the minimum standards in these Guidelines; 2. Ensures that the safety and soundness of the covered institution is not jeopardized by decisions made by the parent company’s board and management; 3. Ensures that the covered institution’s risk profile is easily distinguished and separate from that of its parent for risk management and supervisory reporting purposes; and 4. Consideration of these factors may require the covered institution to have separate and focused governance and risk management practices.”).

bank should be able to leverage the aspects of the framework that appropriately address bank-related risks, rather than requiring a bank to recreate and duplicate functions, personnel, and systems at the bank level.

The proposal recognizes that in certain cases (*i.e.*, where the risk profile of the bank and the holding company is “substantially similar”), it is appropriate for a bank to share the holding company’s risk management framework. However, the test in the proposal for whether a bank has a “substantially similar” risk profile to its parent holding company is vague and uncertain. The proposal provides no guidance as to when a bank’s risk profile and that of its parent company would be “substantially similar,” and, unlike the OCC’s Heightened Standards, the FDIC’s proposal does not contain a quantifiable “safe harbor” that could be relied on when the bank’s total assets exceed a threshold percentage of the parent company’s total assets.<sup>74</sup>

In addition, the proposal is silent on whether a covered institution that does not meet the “substantially similar” test can leverage *any* (as opposed to all) aspects of its parent company’s risk management framework. It is critical that any final guidelines afford such flexibility. Consistent with the OCC’s Heightened Standards,<sup>75</sup> the FDIC should revise the proposal to recognize that, as long as a parent holding company’s risk management framework meets the FDIC’s guidelines, a bank should be able to leverage the aspects of the framework that appropriately address bank-related risks, rather than requiring a bank to recreate and duplicate functions, personnel, and systems at the bank level. Failure to do so could result in costly inefficiencies, operational risk from running duplicate functions, and unnecessary impairment of the ability of a consolidated group to achieve a cohesive, enterprise-wide approach to risk management, which has been identified by the banking agencies as a key regulatory objective, especially for larger institutions.<sup>76</sup>

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<sup>74</sup> 12 C.F.R. pt. 30, app. D, para. I.4.

<sup>75</sup> 79 Fed. Reg. at 54521 (Sep. 11, 2014) (“It is important to note that neither the Proposed Guidelines nor the final Guidelines prohibit a covered bank from using those components of its parent company’s risk governance framework that are appropriate for the covered bank. Indeed, the OCC encourages covered banks to leverage their parent company’s risk governance framework to the extent appropriate, including using employees of the parent company. . . . The OCC recognizes that covered banks operate within their overall parent company’s risk governance framework, and that covered banks may realize efficiencies when their parent company’s risk governance framework is consistent with these Guidelines. . . . The covered bank should work closely with its parent company to promote efficiencies and synergies between the two risk governance frameworks.”).

<sup>76</sup> Dodd-Frank Wall Street Reform and Consumer Protection Act, § 165(h)(3)(A), 12 U.S.C. § 5365(h)(3)(A) (requiring a large bank holding company to establish a risk committee that is “responsible for the oversight of the *enterprise-wide* risk management practices” of the holding company) (emphasis added); 12 C.F.R. §§ 252.22(b)(2)(i), 252.33(b)(2)(i) (requiring a chief risk

Any final guidelines should also clarify the permissibility of common risk management practices that are considered desirable and effective by many institutions. For example, audit, management information, information security, treasury, finance, investment management, legal and other systems and functions operated at the holding company have long been employed by banking organizations without supervisory objection and should continue to be permissible.<sup>77</sup>

Similarly, the use of “dual-hatted” officers at both the bank and holding company is another widespread practice recognized by the FDIC that allows a bank to tap the most qualified personnel at an organization to serve in key roles at the bank and the holding company, increase efficiencies, and provide for a more cohesive approach to enterprise-wide risk management for the consolidated banking organization. For senior management positions in the risk and audit functions, there are significant benefits to having personnel with an enterprise-wide view, such as a deep understanding of the overall organization and inter-affiliate relationships. Banks and their holding companies have therefore been permitted to share such personnel where that practice effectively achieves risk management goals.<sup>78</sup>

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officer of a bank holding company with total consolidated assets of \$50 billion or more to oversee the “establishment of risk limits on an *enterprise-wide* basis and the monitoring of compliance with such limits”) (emphasis added); Federal Reserve, Enhanced Prudential Standards and Early Remediation Requirements for Covered Companies, 77 Fed. Reg. 594, 600 (Jan. 5, 2012) (“Sound, enterprise-wide risk management by covered companies *reduces the likelihood of their material distress or failure and thus promotes financial stability.*”) (emphasis added); *see also* OCC Director’s Book, at 70 (“If the bank is a subsidiary of a holding company, it may be appropriate to implement enterprise risk management corporate-wide.”).

<sup>77</sup> FDIC, Risk Management Manual of Examination Policies § 4.3 (Dec. 2004), at 4.3-8 (“The holding company structure can provide significant benefits from economies of scale in areas such as audit, and data processing services, etc. Effective review of the examination report by the holding company and implementation of recommendations contained therein should assist the FDIC in the supervision of subsidiary banks.”).

<sup>78</sup> *See, e.g.*, FDIC, Risk Management Manual of Examination Policies § 4.3 (Dec. 2004), at 4.3-8 (“The[] economies of scale could extend to the employees in the case of ‘dual employees’ or those that perform essentially the same duties for a banking entity and the affiliated organization. The use of dual-employees can be a cost-effective manner for leveraging in-house expertise or for employees that specialize in certain core competencies.”); 79 Fed. Reg. at 54521 (“Indeed, the OCC encourages covered banks to leverage their parent company’s risk governance framework to the extent appropriate, including using employees of the parent company. For example, it may be appropriate for the same individual to serve as Chief Risk Executive or Chief Audit Executive of a covered bank and its parent company.”).

## II. Additional Clarifying Changes Should Be Made in Any Final Guidelines.

### A. *Strategic plan, risk appetite statement and risk limit breach reporting*

With respect to the provisions in the proposal related to a covered institution's strategic plan,<sup>79</sup> risk appetite statement,<sup>80</sup> and risk limit breach reporting,<sup>81</sup> any final guidelines should be revised to (i) clarify that the CEO is not expected to “develop” the strategic plan but rather direct and oversee its development for his or her review and feedback, and acknowledge that the form in which an institution's strategic objectives are expressed and documented will vary for each organization; (ii) clarify that risk may be aggregated for purposes of establishing risk appetites where it is not possible to disaggregate the risks;<sup>82</sup> (iii) provide for annual, rather than quarterly, review and update of the risk profile and risk appetite statement, with interim reviews as necessary based on the size and volatility of risks and any material changes in the bank's business model, strategy, risk profile or market conditions;<sup>83</sup> and (iv) provide that covered institutions should establish protocols for when and how to inform the board of directors of a risk limit breach, taking into account the severity of the breach, its impact, and the frequency of breaches, rather than suggest that the board receive reporting of every risk limit breach.<sup>84</sup>

### B. *Three lines of defense*

The final guidelines, if issued, should be revised to align generally the proposal's provisions related to the three lines of defense with the OCC's Heightened Standards, including (i) consistent definitions of the three lines of defense<sup>85</sup> and consistent guidance on interpretation of the relevant requirements,<sup>86</sup> including clarity that a bank may utilize a structure with more

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<sup>79</sup> Proposal, 88 Fed. Reg. at 70405.

<sup>80</sup> Proposal, 88 Fed. Reg. at 70407.

<sup>81</sup> Proposal, 88 Fed. Reg. at 70408.

<sup>82</sup> See 12 C.F.R. pt. 30, app. D, para. II.E., n.4.

<sup>83</sup> See 12 C.F.R. pt. 30, app. D, para. II.A, II.G.

<sup>84</sup> See 12 C.F.R. pt. 30, app. D, para. II.H.

<sup>85</sup> See 12 C.F.R. pt. 30, app. D, para. I.E.

<sup>86</sup> See, e.g., 79 Fed. Reg. at 54525 (Sept. 11, 2014) (clarifying that “human resources does not meet any of the three additional criteria, and therefore, is not a front line unit for purposes of these [Heightened Standards] Guidelines”).

than one officer leading the second line of defense;<sup>87</sup> (ii) clarification of the expectation that the front line units should be held accountable for managing the risk of their activities; (iii) clarification that a bank may maintain organizational units whose purpose is to assist a front line unit in fulfilling its responsibilities under the three lines of defense framework;<sup>88</sup> and (iv) conforming the definitions of Chief Audit Officer and Chief Risk Officer, including the reporting line expectations for each officer, to the comparable definitions and standards in the Heightened Standards to avoid interpretive questions.<sup>89</sup>

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<sup>87</sup> As noted by Director McKernan, “[t]he flexibility to have several Chief Risk Executives permits separate second line functions, including, for example, a separate compliance-risk function that is led by a Chief Compliance Officer who reports directly to the CEO and that is overseen by a separate Compliance Committee. The permissibility of a separate compliance-risk function is a point the OCC thought important enough to confirm in a footnote to the OCC Guidelines. However, in a departure from the OCC Guidelines, the proposal seems to contemplate one sole Chief Risk Officer. One interpretation is that the FDIC expects that all second-line risk management responsibilities, including with respect to compliance-risk management, would be overseen by *the* Chief Risk Officer and the Risk Committee. Under that interpretation, the proposal would preclude a separate compliance-risk function.” Statement by Jonathan McKernan, Director, FDIC Board of Directors, on the Proposed Guidelines Establishing Standards for Corporate Governance and Risk Management (Oct. 3, 2023), *available at* <https://www.fdic.gov/news/speeches/2023/spoct0323c.html>. In light of the different arrangements across the banking industry as it relates to the organization of the compliance and risk function, any final guidelines should include the flexibility to have more than one Chief Risk Executive, consistent with the Heightened Standards.

<sup>88</sup> 12 C.F.R. pt. 30, app. D, para. II.C.1.

<sup>89</sup> For example, under the Heightened Standards, both the Chief Risk Executive and the Chief Audit Executive are “one level below the Chief Executive Officer.” 12 C.F.R. pt. 30, app. D., paras. I.E.2–3. The Heightened Standards further provide that “the audit committee or the Chief Executive Officer oversees the Chief Audit Executive’s administrative activities,” but it includes no such language with respect to the Chief Risk Executive. 12 C.F.R. pt. 30, app. D, para. I.E.8(d). With respect to the Chief Risk Executive’s reporting lines, the preamble to the final rule adopting the Heightened Standards clarifies that “the CEO would oversee the [Chief Risk Executive]’s (or [Chief Risk Executives]’) activities in a manner similar to the oversight the CEO provides to other direct reports” and that “disagreements [between independent risk management and front line units] should be resolved by the CEO when the CRE and front line unit(s) executive(s) are unable to resolve these issues,” although of course the Chief Risk Executive has unrestricted access to the board of directors to address risks and issues identified through independent risk management’s activities. 79 Fed. Reg. at 54526; 12 C.F.R. pt. 30, app. D, para. I.E.7(b). The proposal, on the other hand, provides that the Chief Risk Officer “reports directly to the board or the board’s risk committee and, solely for administrative matters, the CEO.” 88 Fed. Reg. at 70404. It does not provide comparable language with respect to the Chief Audit Officer.

### C. *Internal audit*

The proposal would require internal audit to update the audit plan at least quarterly.<sup>90</sup> When proposed, the OCC's Heightened Standards also called for quarterly updates to the audit plan, but the requirement in the final Heightened Standards was adjusted to provide for periodic review and update of the audit plan.<sup>91</sup> The audit plan requirement in any final guidelines should be revised to align with the OCC's Heightened Standards, which allow banks to evaluate the audit plan periodically to account for, among other things, emerging risks and other issues, without imposing an onerous quarterly requirement.

Consistent with the OCC's Heightened Standards, the proposal provides that internal audit should "[i]dentify and communicate to the Audit Committee significant instances where front line units or independent risk management are not adhering to the risk management program."<sup>92</sup> However, the proposal goes beyond the requirements of the Heightened Standards in requiring that "[t]his communication should document instances of identified *or suspected* non-compliance with applicable laws or regulations."<sup>93</sup> As discussed above, any final guidelines should remove any reference to "suspected" violations of laws and regulations. Although we agree that banks must be vigilant in monitoring compliance with laws and actively investigate potential issues, a mandatory escalation requirement applicable to all suspected violations of law could divert important bank resources away from core issues of risk management, especially as it may ultimately be determined that many "suspected" violations are not violations upon further investigation.

### D. *Board appointment of executive officers*

The proposal provides that the board of directors of covered institutions "must select and appoint executive officers who are qualified to administer the covered institution's affairs effectively and soundly," without clarifying which executive officers must be appointed by the board rather than management. Any final guidelines should align with the OCC's Heightened Standards, which provide that the board should appoint the CEO and appoint, or approve the appointment of, a chief audit executive and chief risk executive with the skills and abilities to carry out their roles and responsibilities within the risk governance framework.<sup>94</sup> Boards should use their judgment in determining which of the CEO's direct reports and other

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The inconsistencies with both the language used and the officers to whom the language applies will introduce ambiguity and confusion.

<sup>90</sup> Proposal, 88 Fed. Reg. at 70408.

<sup>91</sup> 12 C.F.R. pt. 30, app. D, para. II.C.3; 79 Fed. Reg. at 54532.

<sup>92</sup> Proposal, 88 Fed. Reg. at 70408; *see* 12 C.F.R. pt. 30, app. D, para. II.C.3.

<sup>93</sup> Proposal, 88 Fed. Reg. at 70408 (emphasis added).

<sup>94</sup> 12 C.F.R. pt. 30, app. D, para. II.L.1.

personnel should be approved by express board action. Of course, the board should be familiar with individuals appointed to senior positions, and, even if the board does not formally act, it should be satisfied with those appointments and take them into account in evaluating the CEO. Further, any final guidelines should remove the reference to “select,” as it could be read to suggest that reviewing and approving management’s recommendation is insufficient.

*E. Board committees*

The proposal appears to suggest that it is “prudent” to establish a separate board credit committee. Although a board credit committee was commonplace for most banks 25 years ago and may still be commonplace for smaller institutions, most larger banks have folded the credit committee into the risk committee. Covered institutions may interpret the FDIC’s language as indicating that board credit committees should be established or re-established. Once again, the suggestion that boards depart from accepted practice creates a divide between the proposal and other sources of instruction for boards generally and bank boards in particular, as well as from accepted practice.

In addition, the proposal suggests that a covered institution should have a board compensation committee. Any final guidelines should clarify that this is not necessary when the full board or another bank board committee carries out the required duties related to performance management and compensation. Further, any final guidelines should clarify that covered institutions have the flexibility to follow their parent entities’ compensation and performance programs as long as those programs reflect existing laws and regulations.<sup>95</sup>

**III. The Proposal Does Not Include an Appropriate Transition Period for Conformance With Any Final Guidelines.**

The proposal does not provide for a transition period to achieve conformance with the new guidelines. If adopted as proposed, it appears compliance would be required for covered institutions on the effective date of the final guidelines. The absence of a transition period in the existing proposal means that many institutions would not meet the standards as of the effective date, which is an inappropriate outcome.

Institutions with assets below the asset threshold on the effective date will also have to conform immediately once they cross that threshold on a future date. The proposal assumes that such institutions would be “well aware in advance if they would exceed the \$10 billion threshold and develop compliance programs in advance or plan to reduce their assets.”<sup>96</sup> The proposal does not provide support for this assumption. To the contrary, growth of bank assets may be driven by external factors that are not within the control of individual banks and are not fully expected by the industry or the regulators.

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<sup>95</sup> See, e.g., 12 C.F.R. pt. 364, app. A.

<sup>96</sup> Proposal, 88 Fed. Reg. at 70394.



If the guidelines are finalized, the FDIC should allow for a sufficient transition period—18 months at a minimum—for banks over the asset threshold today and banks that exceed the asset threshold in the future. If the independent/independent director requirement is not removed from any final guidelines, the transition period should be extended to 24 months at a minimum. Preparing for conformance with new governance and risk management standards, particularly ones that diverge meaningfully from the status quo—for example, the need to identify and onboard new directors as a result of the independent/independent director requirement—requires a substantial amount of time, careful planning and substantial investment of resources from the banking organizations, as has been the experience of those banks subject to the OCC’s Heightened Standards.<sup>97</sup> In addition, in light of the number of other concurrent rulemaking activities by the banking agencies, this proposal, if adopted in the near future, may be overlapping with the compliance timelines of other requirements applicable to the same covered institutions, which would create significant burden. Finally, by issuing these formal guidelines pursuant to Section 39, the FDIC has indicated its authority to take further administrative or enforcement actions when the guidelines are breached. Accordingly, any final guidelines should include an appropriate transition period to achieve compliance.

#### **IV. Conclusion.**

We agree that sound corporate governance promotes bank safety and soundness. We believe, however, that the proposal fails to recognize the costs and burdens it imposes on boards, in particular discouraging and rendering ineligible qualified directors, and thereby actually undermines robust corporate governance. The proposal should be withdrawn and, if reissued, should address the fundamental deficiencies discussed in this letter.

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<sup>97</sup> For example, a comprehensive and thorough evaluation of even one new director can take a full year.

We appreciate the opportunity to comment on the proposal. If you have any questions, please contact the undersigned by email at [Gregg.Rozansky@bpi.com](mailto:Gregg.Rozansky@bpi.com) and David Baris at [dbaris@abd.org](mailto:dbaris@abd.org).

Sincerely,



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