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Mr. James P. Sheesley
Assistant Executive Secretary
Federal Deposit Insurance Corporation
550 17th Street NW
Washington, DC 20429

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

Dear Mr. Sheesley:

The American Bankers Association[1] (ABA) and the undersigned state bankers associations appreciate the opportunity to provide comments to the Federal Deposit Insurance Corporation (FDIC) on its proposed Guidelines Establishing Standards for Corporate Governance and Risk Management for Covered Institutions with Total Consolidated Assets of $10 Billion or More (Proposed Guidelines).[2] In the Proposed Guidelines, FDIC shares that it believes additional, widely applicable FDIC heightened corporate governance standards are necessary to help it better avoid large insured institution failures and related risks such failures pose to the Deposit Insurance Fund (DIF). FDIC generally describes the Proposed Guidelines as a collective restatement of existing FDIC and joint agency guidance and as a means to better align its existing heightened corporate governance standards with those of the Office of the Comptroller of the Currency (OCC) and the Board of Governors of the Federal Reserve System (FRB).[3, 4]

A qualified, well-informed, and active board of directors (board) is vital to an insured institution's safety and soundness. However, FDIC has a responsibility to clearly articulate why its continuous examination process (CEP) and other components of its existing regulatory framework are insufficient to help it better avoid large insured institution failures. If any additional FDIC heightened corporate governance standards are reasonably necessary, FDIC also has a responsibility to avoid generating unreasonable risks as it reshapes prudently managed, already closely supervised institutions' corporate governance.

Regrettably, FDIC has met neither responsibility here, and we must oppose the Proposed Guidelines both on principle and out of significant concern that the Proposed Guidelines would

[1] The American Bankers Association is the voice of the nation's $23.4 trillion banking industry, which is composed of small, regional, and large banks that together employ more than 2.1 million people, safeguard $18.6 trillion in deposits, and extend $12.3 trillion in loans. Learn more at www.aba.com.
[2] 88 Fed. Reg. 70391 (Oct. 11, 2023).
[3] 12 CFR part 30 – OCC's Safety and Soundness Standards.
[4] 12 CFR part 252 – FRB's Enhanced Prudential Standards (Regulation YY).

undermine – not strengthen – the safety and soundness of covered institutions and, in turn, the broader banking industry and the DIF.

We strongly urge FDIC to fully withdraw the Proposed Guidelines.

Alternatively, if FDIC can better articulate why additional FDIC heightened corporate governance standards are reasonably necessary to help it better avoid large insured institution failures, FDIC should develop and propose such standards as principles-based guidance – not as highly prescriptive, enforceable guidelines. Such guidance should align with established principles of prudent corporate governance, be aligned with OCC's and FRB's heightened corporate governance standards, be appropriately tailored to apply only to insured state nonmember institutions that may truly present heightened safety and soundness concerns, and be designed to be applied consistently across covered institutions. Furthermore, FDIC should, like OCC, be expressly clear that it does not intend for such guidance to conflict with or supersede applicable state law.[5]

Brief Summary of the Proposed Guidelines

Covered Institutions

The Proposed Guidelines would be issued as Appendix C to FDIC's standards for safety and soundness regulations found at 12 CFR part 364 and would ostensibly apply to all insured state nonmember banks, state-licensed insured branches of foreign banks, and insured state savings associations that are subject to the provisions of Section 39 of the Federal Deposit Insurance Act (FDI Act) and have total consolidated assets of $10 billion or more (collectively, covered institutions). The Proposed Guidelines would define an institution's total consolidated assets as the total assets reported on the institution's Consolidated Reports of Condition and Income (Call Report) for the two most recent quarters. Under the Proposed Guidelines, if a covered institution's Call Reports for four consecutive quarters show the institution's total consolidated assets fell below the $10 billion threshold, the institution would generally no longer be considered a covered institution.

However, as it pains to make clear, FDIC would reserve its authority and discretion to apply any additional heightened corporate governance standards it adopts to any insured state nonmember institution with total consolidated assets of less than $10 billion if FDIC determines that the institution's operations are highly complex or present heightened safety and soundness risks. Similarly, FDIC would reserve its authority and discretion to postpone any covered institution's mandatory compliance and to waive any otherwise covered institution's mandatory compliance altogether.

[5] OCC's Director's Book – Role of Directors for National Banks and Federal Savings Associations (Nov. 2020), Footnote 4.

Enforceability

Unlike FDIC and joint agency guidance on which portions of the Proposed Guidelines may be based, the Proposed Guidelines would be enforceable under Section 39 of the FDI Act. Directors deemed in violation of the Proposed Guidelines would, therefore, be subject to removal, criminal prosecution, civil money penalties, and civil liability.

New Director, Board, and Board Committee Standards

The Proposed Guidelines would impose a wide range of significant new standards on covered institutions' directors and would establish highly detailed board composition expectations, including that a board be at least majority-independent and diverse across a range of personal attributes and experiences. The Proposed Guidelines would also require a board and board committees to become significantly more involved – and, in some instances – ultimately responsible for largely operational processes best carried out by executive and non-executive management.

Notably, in describing several new standards, the Proposed Guidelines adopt the word *ensure* and similarly narrow verbs – such as when proposing to require that a board "*ensure* that management corrects deficiencies that auditors or examiners identify in a timely manner."

General Comments

FDIC raises the specter of large insured institution failures as proof that additional FDIC heightened corporate governance standards are necessary. To be sure, failure of any FDIC-insured institution poses some risks to the DIF, and those risks can, in some instances, rise alongside an institution's asset size. However, given many of FDIC's proposals to reshape prudently managed, already closely supervised institutions' corporate governance carry both obviously material and unpredictable risks, FDIC's primary justification for proposing such standards demands close scrutiny.

Both Signature Bank and First Republic Bank, the most notable FDIC-examined institutions that failed in early 2023, were subject to FDIC's CEP for years prior to their failure. At institutions subject to FDIC's CEP, in addition to conducting standard safety and soundness examinations, dedicated FDIC staff conduct targeted reviews and ongoing, on-site supervisory examinations and institution monitoring. And at no point in the Proposed Guidelines does FDIC articulate how its CEP and other components of its existing regulatory framework were insufficient to identify and avoid, or at least help remediate, the risks that, when realized, ultimately led to those failures.

Conversely, in its reports on its supervision of Signature Bank and First Republic Bank, FDIC plainly acknowledges that it accurately and precisely identified the risks most substantially contributing to those failures well before those failures occurred. With respect to those failures, FDIC was not hampered by a lack of sufficiently robust regulatory tools.

At Signature Bank, FDIC examiners identified "recurring liquidity risk management and other weaknesses [and] made numerous supervisory recommendations (SRs) including Matters Requiring Board Attention (MRBAs)" – some of which remained outstanding for multiple examination cycles.[6] FDIC acknowledges that "[g]iven the recurring liquidity control weaknesses, [Signature Bank's] unrestrained growth, and management's slow response to address findings, it would have been prudent to downgrade the Management component rating to '3,' (i.e., needs improvement) as early as the second half of 2021. Doing so would have been consistent with [the Division of Risk Management Supervision's (RMS)] forward-looking supervision concept, likely lowered [Signature Bank's] Composite rating, and supported consideration of an enforcement action." Instead, FDIC rated Signature Bank's board and management performance as satisfactory until March 11, 2023 – right up to its closure by the New York State Department of Financial Services.

In its September 2023 report on its supervision of First Republic Bank, FDIC notes "[…] First Republic had historically been a respected, well-run bank and was responsive to supervisory feedback and recommendations. Reports of examination (ROEs) noted that the bank grew consistently, but implemented and maintained infrastructure, controls, and risk management processes commensurate with its size and risk profile."[7] Unlike Signature Bank, First Republic Bank received "relatively few" SRs.

Yet, FDIC was well aware that "there were attributes of First Republic's business model and management strategies that made it more vulnerable to interest rate changes" and "RMS could have done more to effectively challenge and encourage bank management to implement strategies to mitigate interest rate risk starting in the second half of 2021". FDIC also acknowledges, "RMS could have pursued a more urgent supervisory response, such as potentially downgrading the Sensitivity to Market Risk component (of First Republic Bank's CAMELS rating) and/or issuing SRs urging management to develop strategies to mitigate interest rate risk when it learned in August 2022 of First Republic's interest rate risk scenario results that were far outside of Board-approved parameters."

Review and thorough consideration of these two reports and FDIC's acknowledged shortcomings would perhaps be less valuable if only the very largest FDIC-examined institutions were subject to FDIC's CEP. But these reports are instructive precisely because the Proposed Guidelines' covered institutions are already subject to its CEP, which also has a $10 billion threshold.

Therefore, we strongly urge FDIC to fully withdraw the Proposed Guidelines and abstain from promulgating any additional heightened corporate governance standards – at least until FDIC can better articulate why its CEP and other components of its existing regulatory framework are insufficient to help it better avoid large insured institution failures. FDIC should resist a knee-jerk impulse to attempt to avoid similar failures and protect the DIF by rushing to impose a wide

[6] FDIC's Supervision of Signature Bank (April 28, 2023).
[7] FDIC's Supervision of First Republic Bank (Sept. 8, 2023).

array of highly prescriptive heightened corporate governance standards on dozens of prudently managed, already closely supervised institutions. Rather, FDIC should utilize its existing, sufficiently robust regulatory tools to better supervise and assist the relatively few institutions that may truly present heightened safety and soundness concerns.

It is fundamentally important that the federal banking agencies' heightened corporate governance standards be aligned. Though OCC and FRB heightened corporate governance standards are not identical, both are principles-based. The Proposed Guidelines are, in stark contrast, highly prescriptive and ignore meaningful nuances among a broad population of healthy institutions and state laws to which those institutions are subject, conflate the most basic divisions of responsibility among directors and management, and, in places, mandate patently unachievable outcomes. Such significant misalignment between federal banking agencies' heightened corporate governance standards would create significant regulatory uncertainty and other myriad unreasonable, wholly avoidable risks and dramatically upset fair competition among covered institutions.

Faced with comparatively high compliance costs, FDIC's covered institutions would likely be forced to raise prices and, perhaps, could be forced to reduce or delay some financial inclusion efforts. In application, the Proposed Guidelines could place covered institutions at such a competitive disadvantage to nationally chartered institutions that a covered institution's board would be imprudent to not consider converting its charter to a national charter. The Proposed Guidelines would likely also pose particularly acute challenges for family-owned covered institutions and covered institutions with modest and remote geographic footprints, overlapping boards, and parent institutions subject to other OCC and FRB standards and requirements.

Specific Concerns

I. Definitions.

The Proposed Guidelines would require that a Chief Risk Officer be "experienced in identifying, assessing, and managing risk exposures of *large financial firms*." Similarly, the Proposed Guidelines would require that a covered institution's Risk Committee include at least one member "experienced in identifying, assessing, and managing risk exposures of *large firms*." However, because FDIC proposes no definition for either *large financial firm* or *large firm*, these proposed standards risk creating significant regulatory uncertainty with respect to some of those on whom the Proposed Guidelines place the greatest emphasis.

If additional FDIC heightened corporate governance standards are reasonably necessary and include mention of *large financial firm* or *large firm*, we encourage FDIC to clearly define these terms.

II. Enforceable heightened standards are unnecessary and can produce harmful, illogical outcomes.

If additional FDIC heightened corporate governance standards are reasonably necessary, we strongly urge FDIC to adopt such standards as principles-based guidance – not as highly prescriptive, enforceable guidelines.

While some components of the Proposed Guidelines may closely resemble previously issued FDIC and joint agency guidance, there are meaningful legal and operational differences between otherwise identical guidance and guidelines. And, as FRB has shown in SR 16-11: Supervisory Guidance for Assessing Risk Management at Supervised Institutions with Total Consolidated Assets Less than $100 Billion, a federal banking regulator can, without being overly prescriptive, successfully leverage guidance to address the same heightened corporate governance and risk management concerns the Proposed Guidelines are intended to address. By issuing guidance, a federal banking regulator can quickly provide much needed regulatory clarity and support to the banking industry without bluntly forcing prudently managed, already closely supervised institutions to abandon well-tailored, smoothly functioning corporate governance and risk management practices.

Contrastingly, the Proposed Guidelines would be enforceable under Section 39 of the FDI Act. Enforceability is an important and often invaluable component of federal banking regulation. However, Section 39 enforceability is wholly inappropriate where strict compliance is not only unnecessary but would variously be functionally impossible, risk violation of other applicable laws, regulations, and fiduciary standards, and would otherwise undermine the safety and soundness of covered institutions.

For example, as highlighted above, the FDIC proposes to require that a board "*ensure* that management corrects deficiencies that auditors or examiners identify in a timely manner." Every day, boards across the country prudently comply with the spirit of this proposed standard. Directors take all reasonable steps to assure that they and their fellow directors are qualified, well-informed, and hold management to appropriately high ethical and professional standards. However, no board can strictly comply with the proposed standard because it, like others, is unspecific and conflates the responsibilities and capacities of directors and management.

The illogical outcomes the Proposed Guidelines appear likely to produce would not only be immediately harmful to individual covered institutions but risk undermining the quality of the broader banking industry's corporate governance. Faced with potentially immense personal liability for failing to do the impossible, qualified directors and qualified bank director candidates may well rush out of banking altogether. To avoid this potentially irreversible calamity, if additional FDIC heightened corporate governance standards are reasonably necessary, it of paramount importance that FDIC be expressly clear that it does not intend for such standards to conflict with or supersede applicable state law.

III. The proposed $10 billion "covered institution" asset threshold is far too low.

In the Proposed Guidelines, FDIC references heightened standards for OCC-supervised institutions with average consolidated assets of $50 billion or more. FDIC also references heightened standards contained in the FRB's Regulation YY and various Supervision and Regulation Letters for bank holding companies with total consolidated assets of $50 billion or more. Curiously, though, rather than establish a similar covered institution threshold at $50 billion, FDIC proposes to adopt a much lower $10 billion threshold – seemingly for no reason other than those institutions are already subject to FDIC's CEP.

As part of its CEP, FDIC has a well-established process for identifying more complex institutions and institutions FDIC believes may present a higher-than-average risk profile. Whenever an FDIC examiner determines a targeted review of a CEP-subject institution's risks, policies, procedures, or financial condition is necessary to complete an examination, FDIC specialists have uninterrupted access to that institution. That FDIC-supervised institutions with assets of $10 billion or more are already subject to FDIC's CEP is hardly justification for imposing on all those prudently managed, already closely supervised institutions additional, highly prescriptive heightened corporate governance standards. It is, in fact, all the more reason for FDIC to adopt an initial covered institution asset threshold at least consistent with OCC's and FRB's heightened standards for larger institutions with potentially more complex risk profiles. Furthermore, substantial compliance costs incurred by covered institutions and by institutions that reasonably expect to be identified as covered institutions will, as always, ultimately raise the costs of consumer financial services products, particularly at smaller institutions.

We strongly encourage FDIC to adopt an initial covered institution asset threshold of at least $50 billion and establish a procedure for its regular inflation-based adjustment.

IV. The Proposed Guidelines would fundamentally reshape covered institutions' corporate governance and carry unreasonable but wholly avoidable risks.

Unlike prior FDIC guidance and OCC and FRB heightened standards, which place a greater emphasis on the role of senior management with board oversight, the Proposed Guidelines would force a significant change in the relationship between directors and management. Consequently, while we outline a number of concerns in this letter, we are keenly aware and urge FDIC to consider that such a sea change in corporate governance standards could and likely would produce other unintended, at least equally detrimental outcomes that cannot yet be predicted.

CORPORATE GOVERNANCE

General Obligations of the Board

The Proposed Guidelines would require directors, irrespective of applicable state shareholder or stakeholder fiduciary standards, to consider, "the interests of all its stakeholders, including shareholders, depositors, creditors, customers, regulators, and the public." Applicable state laws

notwithstanding, directors deemed in violation of this proposed new standard could potentially be subject to removal, criminal prosecution, civil money penalties, and civil liability.

Each of the Proposed Guidelines' covered institutions is state-chartered or state-licensed, and its directors are, therefore, subject to some state fiduciary standard. The Delaware fiduciary standard, by far the most influential, provides that directors have a non-delegable duty of loyalty to act in the best interests of their institution and its shareholders. Though Delaware's shareholder primacy rule may be broad enough to permit directors to consider the interests of some non-shareholder stakeholders, directors must believe those interests have a reasonable nexus to enhancing or protecting shareholders' interests. Not only is it unclear how any director could accurately and reliably identify and evaluate the interests of regulators and the general public, but a director could very reasonably conclude that the interests of those and other non-shareholder stakeholders have no reasonable nexus to enhancing or protecting shareholders' interests. Some states' fiduciary standards arguably allow directors greater discretion, but none are so broad as to allow strict compliance with the proposed standard.

We strongly urge FDIC to recognize and respect the role and value of state fiduciary standards and to fully withdraw this proposed standard. Alternatively, we recommend that FDIC amend this proposed standard to clearly convey that a board may consider the interests of stakeholders to the extent permitted by all applicable laws, regulations, and their institution's bylaws.

Board Composition – Diversity

The Proposed Guidelines provide that a covered institution's "board should consider how the selection of and diversity among board members collectively and individually may best promote effective, independent oversight of covered institution management and satisfy all legal requirements for outside and independent directors. Important aspects of diversity may include: social, racial, ethnic, gender, and age differences[.]"

We strongly support diversity, equity, and inclusion in the workplace. And FDIC is plainly right that boards can, and often do, benefit from a diversity of experiences. Yet, however well-intentioned, as written, this proposed standard that a board consider existing and potential directors' race, ethnicity, gender, and age is wholly inappropriate and likely subject to legal challenge.[8] Furthermore, given most, if not all, jurisdictions require that a chartered institution's board be comprised of a majority of directors resident in their jurisdiction, the proposed standard would create significant regulatory uncertainty in the most geographically remote jurisdictions and other, largely rural jurisdictions that may be less racially and ethnically diverse than the country is as a whole.

We strongly urge FDIC to withdraw the proposed standard and to be exceptionally careful and realistic in how it sets expectations of individual directors and boards' composition and how it describes those expectations. As Vice Chairman Hill poignantly expressed in his dissenting

[8] *See generally* Students for Fair Admissions v. Harvard, 600 U.S. 181 (2023).

statement, on an insured institution's board, there is simply no substitute for relevant banking experience and expertise.

Board Composition – Independent Director Majority

It is unclear why FDIC feels it prudent to adopt a standard requiring covered institutions to adopt a majority independent board. Such a standard goes far beyond what OCC and FRB feel is necessary for their far larger and, in some cases, far more complex institutions. The Proposed Guideline's covered institutions are already subject to independent audit committee standards under Section 36 of the FDI Act and part 363 of FDIC's regulations. Furthermore, many of the Proposed Guidelines' covered institutions have modest or remote geographic footprints. Many are closely held, and some even remain family owned. The proposed standard ignores the value of directors keenly attuned to a covered institution's history, community, and roadmap, and ignores the realities of our nation's director population and pipeline.

The boards of many prudently run covered institutions are not majority independent today. The nation's insured institution director population is aging, and the pipeline of qualified director candidates is already insufficient to meet existing needs. Under any enforceable standards FDIC adopts pursuant to Section 39 of the FDI Act, covered institutions' directors will face significantly increased potential personal liability. Likely, this change will encourage many existing directors to retire or otherwise withdraw from their institutions and also discourage many of the already too few qualified director candidates from accepting directorships. These are the realities of our nation's insured institution director population and pipeline with which all covered institutions are forced to contend. Some covered institutions, including many in comparatively remote locations, may have access to substantially less director talent still.

To meet FDIC's proposed standard, covered institutions may be able to increase the number of directors on their boards and attract independent directors to fill those openings. However, many covered institutions simply lack the resources to successfully compete for the already too few available qualified independent director candidates. Those institutions unable to attract enough new independent directors to meet FDIC's proposed standard would be forced to shrink their boards and cut insider directors – irrespective of those directors' value to their institution.

Whatever benefits a few covered institutions may gain from the addition of new independent directors will likely be far outweighed by the risks to most covered institutions posed by the unnecessary exclusion of long-serving insider directors whose services have materially contributed to their institutions' strength and resilience. However qualified, well-informed, and active independent directors may be, at family-owned and other closely held covered institutions, the proposed standard would effectively pull an institution's most significant governance and planning decisions from those with the greatest incentives to see the institution succeed and hand those decisions to non-owners.

We encourage FDIC to withdraw this proposed standard.

Additionally, FDIC's proposed novel definition of an independent director – i.e. a director that is "not a principal, member, officer, or employee of the institution [or of] any affiliate or principal shareholder of the institution" – would prohibit directors serving on a bank holding company board from serving on a wholly-owned covered institution's board. Such a standard would be inconsistent with OCC and FRB standards and would upend prudently composed boards across broad swaths of the banking industry. Overlapping boards at the bank and holding company levels are not only time- and cost-efficient but better support enterprise-wide risk management and provide many institutions exceptional director talent perhaps otherwise unavailable to them.

We encourage FDIC to withdraw the proposed definition. At a minimum, FDIC should clarify that serving on the board of a bank holding company would not disqualify an individual from being an independent director of a wholly owned covered institution.

Duties of the Board

Set an Appropriate Tone

Here and elsewhere the Proposed Guidelines risk, perhaps inadvertently, disturbing well-functioning divisions of responsibility among a board and management by using *establish* and similarly narrow verbs. Boards, OCC recognizes, have a responsibility to *foster* and *maintain* their institutions' sound corporate and risk cultures. FRB recognizes that "the culture, expectations, and incentives established by the highest levels of corporate leadership set the tone for the entire organization […]" but, all importantly, neither OCC nor FRB identifies these duties as belonging solely to a board.

We encourage FDIC to withdraw this proposed standard. At a minimum, FDIC should replace *establish* with *foster*, *maintain*, or some similar word or phrase that recognizes that setting an appropriate tone at the top is the collective responsibility of a covered institution's board and management, not the board's alone.

Approve Strategic Plan for the Covered Institution

FDIC proposes to require that, "[a]t least annually, the board should […] ensure the strategic plan is consistent with policies the board has approved." As discussed more fully below under the subheading *Provide Active Oversight of Management*, FDIC's proposed use of *ensure* risks creating significant uncertainty by establishing a standard with which strict compliance is either functionally impossible or so cumbersome as to be unrealistic.

Presumably, a board could meet the spirit of the proposed standard by providing management with clear objectives, monitoring management's efforts to implement the strategic plan, and responding to unanticipated external developments. However, requiring that a board *ensure* the strategic plan is consistent with board-approved policies raises the question, among others, as to whether a board must go further and independently pre-test management's proposals and assess their performance against existing board-approved policies before approving the strategic plan. While both OCC and FRB have previously used *ensure* to describe board responsibilities, both

agencies not only express their heightened standards in principles-based form but have also intentionally moved away from using *ensure* to describe board responsibilities over which directors do not have total, sole control – as is the case here.

We encourage FDIC to withdraw this proposed standard and all other proposed standards as part of which it uses *ensure* and similarly narrow verbs to describe board responsibilities over which directors do not have total, sole control.

Approve Policies

The Proposed Guidelines provide "[t]he board is responsible for 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." Not only does such an overly broad standard ignore that a board simply cannot and should not be required to review and approve every operational policy – of which there could be hundreds comprising tens of thousands of pages, even at small covered institutions, but there is simply no need for such a standard.

Already, a board's regular review of its institution's primary operational policies is part and parcel of the board's effectively overseeing management. And prudent discharge of a board's core responsibilities naturally entails a board adopting a risk-based policy review approach and delving more deeply into operational policies and procedures as necessary.

We encourage FDIC to withdraw the proposed standard.

Establish a Code of Ethics

FDIC proposes to require that a "board should *establish* a written code of ethics for the covered institution, covering directors, management, and employees." A board may, as part of its broader oversight function, review some parts of a covered institution's framework to promote high ethical standards. But it is entirely inappropriate to task the board with *establishing* such a framework – clearly something best coordinated by executive management and carried out by management across a covered institution.

Furthermore, there is not, as FDIC appears to suggest, only one path a covered institution may follow to promote high ethical standards. Covered institutions prudently promote high ethical standards through various combinations of policies and procedures. Naturally, policies guarding against conflicts of interests are often entirely separate from policies guarding against misuse of a covered institution's assets. A covered institution may have quite a few procedures that, together, uphold the integrity of the institution's financial recordkeeping. Separate sets of policies and procedures collectively promote the institution's compliance with other laws and regulations, including whistleblower protections. A covered institution can quickly, fully respond to ethical challenges it may face precisely because it can have separate policies and procedures – all of which individually and collectively promote high ethical standards.

We encourage FDIC to withdraw the proposed standard.

Provide Active Oversight of Management

The Proposed Guidelines provide that a "board should hold management accountable for adhering to the strategic plan and approved policies and procedures to *ensure* the covered institution's compliance with safe and sound banking practices and all applicable laws and regulations." The Proposed Guidelines also provide that a "board also must *ensure* that management corrects deficiencies that auditors or examiners identify in a timely manner." FDIC's uses of *ensure* in this section again conflates a board's oversight functions and management's day-to-day operational functions and would deprive covered institutions of fundamental exam appellate rights.

A board certainly must hold management accountable for adhering to an institution's strategic plan and approved policies and procedures. And if a covered institution's management routinely fails or refuses to ensure the covered institution's compliance with safe and sound banking practices and all applicable laws and regulations, the board has a responsibility to replace management. But, unless FDIC intends to require that a covered institution's board usurp management's day-to-day operational functions, it is unreasonable to expect that any board can effectively *ensure* a covered institution's compliance with safe and sound banking practices and all applicable laws and regulations.

FDIC's proposal to require covered institutions' boards to *ensure* that management corrects deficiencies that auditors or examiners *identify* goes a step further in the wrong direction. Not only is it similarly unreasonable to expect that any board can effectively *ensure* that management corrects identified audit or exam deficiencies, but as written, the Proposed Guidelines ignore that FDIC-examined institutions have a right to appeal identified audit or exam deficiencies. Because any additional FDIC heightened corporate governance standards FDIC adopts pursuant to Section 39 of the FDI Act will create corresponding personal liabilities for covered institutions' directors, the Proposed Guidelines would force directors to choose between replacing management who insist on appealing identified audit or exam deficiencies and exposing themselves to personal liability for failing to replace management, the most drastic oversight mechanism available to them.

We strongly encourage FDIC to withdraw the proposed standard.

Exercise Independent Judgment

Unquestionably, every director must act consistent with his or her fiduciary duties by exercising independent judgment that he or she reasonably believes is prudent.

The proposed standard, however, is wholly unnecessary. Every covered institution's directors are already subject to state fiduciary standards and FDIC regulations that establish and clearly articulate directors' responsibility to exercise independent judgment they reasonably believe to be prudent and provide effective challenge to management. These existing standards and regulations also already appropriately protect a boards' authority to seek information from not only a CEO but also other executives, managers, regulators, and relevant third parties and protect

individual directors' opportunities to raise issues, express concerns, and otherwise be fairly heard. The proposed standard flatly ignores the value and strength of these existing standards and regulations.

Furthermore, the proposed standard risks FDIC creating regulatory uncertainty for all covered institutions. First, the proposed standard would define a *dominant policymaker* as "management, a director, a shareholder, or any combination thereof". Under such a broad standard, not only is it clear that every covered institution could easily be deemed to have a *dominant policymaker*, but it is difficult to imagine how any covered institution could avoid that determination.

The overly broad proposed definition would create regulatory uncertainty most obviously for family-owned and other closely held covered institutions even though each has already been subject to close scrutiny in the chartering and deposit insurance qualification processes and is subject, on an ongoing basis, to appropriately strict corporate governance bylaw provisions. But the proposed standard's broad *dominant policymaker* definition is hardly limited to large and majority shareholders. At covered institutions with more broadly distributed equity, most any CEO and broader executive group would likely fall within the proposed definition – particularly if a covered institution's management solicits shareholder proxy votes, as is common.

Second, the proposed standard narrowly focuses on specific types of risks that a dominant policymaker may pose to directors' exercise of sound, independent judgment and offers no explanation or guidance as to how directors may accurately identify a potentially dominant policymaker or protect themselves from one's undue influence – or, equally importantly, as to how an examiner may evaluate a director's efforts to ensure his or her independence. As a result, the proposed standard would effectively turn existing fiduciary standards on their head and create a rebuttable examiner presumption that every director is, absent evidence to the contrary, unduly influenced by some dominant policymaker.

Applicable state fiduciary standards and existing FDIC regulations and guidance already accomplish what FDIC hopes to accomplish by establishing the proposed standard. And no director's judgment should, as the proposed standard risks, be presumed to be impaired based on the mere existence of a dominant policymaker – however the term is ultimately defined. Like many other unnecessary and highly prescriptive proposed standards discussed in this comment, the proposed standard would fundamentally reshape directors' responsibilities and so greatly increase their potential individual liability as to discourage existing directors from continuing to serve covered institutions and existing and potential qualified director candidates from ever serving covered institutions.

We encourage FDIC to withdraw the proposed standard.

Select and Appoint Qualified Executive Officers

The Proposed Guidelines provide that, a "board must select and appoint executive officers who are qualified to administer the covered institution's affairs effectively and soundly." Here, the Proposed Guidelines again conflate a board's oversight functions and management's day-to-day

operational functions. The proposed standard also risks misinterpretation of a board's fiduciary responsibilities to exercise prudence and reasonable judgment in selecting executive management and to hold executive management accountable.

Broadly speaking, selecting a chief executive officer (CEO) is among a board's most critical functions, and, in some states, a non-CEO executive's hiring may require board approval. However, most often, while a CEO may consult a board when identifying qualified executive candidates, a CEO is ultimately responsible for selecting an institution's other executives. Relieving a covered institutions' CEO of the authority to select other executives with whom the CEO will work closely on a daily basis and who the CEO believes will best serve the institution would upend more than a century of organized bank governance practices in many jurisdictions and risks undermining the smooth functioning of many covered institutions.

A board has a fiduciary responsibility both to exercise prudence and reasonable judgment in selecting a CEO and to hold executive management accountable – which can, in extreme cases, include terminating any executive who fails to uphold compliance with the institution's strategic plan, approved policies and procedures, safe and sound banking practices, and all applicable laws and regulations. But FDIC should be careful to not establish a standard that could be easily misinterpreted to suggest a board has a responsibility to effectively guarantee individual executives' performance.

We encourage FDIC to withdraw the proposed standard. Alternatively, FDIC should describe a board's relevant responsibilities clearly. Better language would provide that a board, consistent with its fiduciary duties, must select and appoint a CEO – and other executives it chooses to select and appoint or who state or federal law or applicable bylaws require it to select and appoint – who the board reasonably believes, at the time of selection and appointment, to be able to administer the covered institution's affairs effectively and soundly in their defined role.

Self-assessments

FDIC proposes to require that a board "conduct an annual self-assessment evaluating its effectiveness in meeting" the Proposed Guidelines. Against the ever-present backdrop of potential Section 39 personal liability, requiring a board to evaluate its compliance with any enforceable heightened standards would have a chilling effect on the candor of the broader board self-assessment process and undermine its usefulness. Requiring a board to evaluate its compliance with such highly prescriptive enforceable standards as those contained in the Proposed Guidelines would fundamentally reduce what are now healthfully robust, dynamic discussions to a fruitless, check-the-box exercise.

We encourage FDIC to withdraw the proposed standard.

Committees of the Board

Throughout the Proposed Guidelines, FDIC conflates the distinctly different roles of a board and management. FDIC does the same here when describing the responsibilities of board

committees. For example, the Proposed Guidelines require that a covered institution's Audit Committee "[approve] all decisions regarding the appointment or removal and annual compensation and salary adjustment for the CAO". Similarly, the Proposed Guidelines require that a covered institution's Risk Committee "Review and approve all decisions regarding the appointment or removal of the CRO [] and ensure that the CRO's compensation is consistent with providing an objective assessment of the risks taken by the covered institution."

We encourage FDIC to withdraw these and similar standards that vastly exceed prudent corporate governance standards laid out in state law, relevant model bylaws, and OCC's and FRB's relevant heightened corporate governance standards and would saddle board committees with duties best carried out by management.

Here, too, FDIC unnecessarily risks creating additional regulatory uncertainty by failing to consistently describe the types and responsibilities of different board committees. For example, it is unclear under the Proposed Guidelines whether FDIC expects every covered institution to have a Compensation Committee. FDIC describes an Audit Committee and Risk Committee as *must haves* and provides that covered institutions with trust powers *should have* a Trust Committee. Yet, FDIC describes the responsibilities of a covered institution's Compensation Committee without clarifying whether every covered institution *must have* a Compensation Committee or, only if certain criteria are met, *should have* a Compensation Committee.

We encourage FDIC to withdraw the proposed standard regarding a Compensation Committee and to avoid promulgating additional proposed standards for other, yet-specified board committee types. As the proposed standard tacitly recognizes in its consideration of Other Committees, by and large, a covered institution's board should be free to determine what board committees are necessary and appropriate to support its prudent and efficient oversight based on the complexity, strategy, and risk appetite of its institution. FDIC could adequately examine a covered institution's need for a Compensation Committee and its performance under the proposed standards generally applicable to Other Committees established at a board's discretion.

BOARD AND MANAGEMENT RESPONSIBILITIES REGARDING RISK MANAGEMENT AND AUDIT

FDIC proposes to permit a covered institution with a parent company to adopt and implement all or part of its parent company's risk management program that satisfies the Proposed Guidelines *only if the risk profiles of each entity are substantially similar*.

What constitutes *substantially similar* under the Proposed Guidelines is unclear. Yet, the proposed standard would be unduly prescriptive however the term is defined because the proposed standard would effectively prohibit a covered institution from adopting *any* part of a parent company's risk management program if the entities' risk profiles are not substantially similar – irrespective of whether such dissimilarities have any bearing on the prudence of adopting any part of a parent company's risk management program.

A board should be free to determine what aspects of a parent company's risk management framework should also be applied to the institution, even if the entities have somewhat different risk profiles. Common elements in risk management frameworks at the bank and holding company levels strengthen enterprise-wide compliance.

We encourage FDIC to withdraw the proposed standard. At a minimum, FDIC should strike the *substantially similar* qualifier from this and any similar standard FDIC may subsequently develop.

Risk Profile and Risk Appetite Statement

The Proposed Guidelines provide that a covered institution should review its Risk Appetite Statement (RAS) quarterly. Contrastingly, OCC requires that its covered institutions review their RASs at least annually – more frequently, as may be necessary based on the size and volatility of relevant risks and any material changes in an institution's business model. FRB's periodic RAS review expectation is even less stringent. By requiring an institution to review its RAS far more frequently than is necessary, FDIC risks turning an important risk management exercise into a check-the-box activity.

We encourage FDIC to withdraw the proposed standard. Alternatively, we encourage FDIC to adopt a mandatory RAS review frequency of not less than one year.

Processes Governing Risk Limit Breaches

FDIC proposes to require that a board establish processes requiring front line units and the independent risk management unit to "identify known or suspected violations of the [RAS], concentration risk limits, and front line unit risk limits" and "distinguish breaches based on the severity of their impact on the covered institution." The proposed standard would further require that these units expressly inform "front line unit management, the CRO, the Risk Committee, the Audit Committee, the CEO, *and the FDIC*" of such developments and suspected developments and describe "the severity of the breach, its impact on the covered institution, and how the breach will be, or has been, resolved."

The proposed standard is woefully overbroad and conflates the distinctly different roles of front line units, front line unit management, executive management, and a board. As a primary matter, requiring any of these groups to report *suspected* violations of the RAS, concentration risk limits, and front line unit risk limits – or violations of law or regulation, as discussed below – *to the FDIC* would immediately induce a flood of unnecessary and immaterial notices that would overwhelm FDIC's available resources to evaluate and provide guidance on such issues, where appropriate.

Furthermore, under the proposed standard, front line and independent risk management units would be tasked with reporting such incidents or suspected incidents *directly to FDIC*, bypassing front line unit management, executive management, and the board. Even if FDIC clarified the format and avenue through which it expects front line and independent risk management units to

provide such reports, the proposed standard would remain wholly inappropriate because it effectively requires front line and independent risk management units to act with the insight, expertise, and diligence of front line unit management, executive management, and a board and to effectively usurp their authority to direct and oversee the covered institution's evaluation of and responses to such incidents.

We encourage FDIC to withdraw the proposed standard. At a minimum, FDIC should amend the proposed standard to limit reportable violations of the RAS, concentration risk limits, and front line unit risk limits to only known, material violations and to make such violations reportable to the FDIC only by a board at the board's discretion.

Processes Governing Identification of and Response to Violations of Law or Regulations

Similarly, FDIC proposes to require that a board establish processes requiring front line and risk management employees to "identify known or suspected violations of law or regulations." Again, FDIC's proposed standard is overly broad, conflates the respective roles of a board and management, and would saddle the board with duties best carried out by management. We encourage FDIC to withdraw the proposed standard. At a minimum, FDIC should amend the proposed standard to require that a board direct management to develop relevant policies that are subject to the board's review and adoption and limit reportable violations of law or regulation to only known, material violations.

Need for a Reasonable Mandatory Compliance Transition Period

Under the Proposed Guidelines, once deemed a covered institution, an institution would immediately be subject to FDIC's additional heightened corporate governance standards – unless FDIC provides otherwise on some undefined, ad-hoc basis. However, no institution could prudently overhaul its corporate governance structure and practices to meet FDIC's wide-ranging, highly prescriptive proposed standards overnight. Identifying, vetting, and installing new directors can alone take more than a year.

Furthermore, under the Proposed Guidelines, a covered institution's existing directors could be held personally liable for their institution's failing to do the impossible. As a result, FDIC's adopting the Proposed Guidelines or similar additional heightened corporate governance standards without providing for a reasonable mandatory compliance transition period would set off a stampede of exiting directors at institutions both above and near the covered institution threshold.

If additional FDIC heightened corporate governance standards are reasonably necessary, we strongly encourage FDIC to make a reasonable mandatory compliance transition period part of any subsequently revised proposal. Such a mandatory compliance transition period should be at least two years from FDIC's adoption of such standards or from an institution's becoming a covered institution, whichever is later.

Conclusion

Thank you for your consideration of our views and recommendations. The Proposed Guidelines would fundamentally reshape prudently managed, already closely supervised institutions' corporate governance and carry both obviously material and unpredictable risks. We strongly urge FDIC to fully withdraw the Proposed Guidelines and to be patient, thorough, and thoughtful as it considers next steps. We would be glad to meet with FDIC staff at their convenience. Please do not hesitate to contact me at DBaker@aba.com.

Sincerely,

American Bankers Association
Alabama Bankers Association
Alaska Bankers Association
Arizona Bankers Association
Arkansas Bankers Association
California Bankers Association
Colorado Bankers Association
Connecticut Bankers Association
DC Bankers Association
Delaware Bankers Association
Florida Bankers Association
Georgia Bankers Association
Hawaii Bankers Association
Idaho Bankers Association
Illinois Bankers Association
Indiana Bankers Association
Iowa Bankers Association
Kansas Bankers Association
Kentucky Bankers Association
Louisiana Bankers Association
Maine Bankers Association
Maryland Bankers Association
Massachusetts Bankers Association
Michigan Bankers Association
Minnesota Bankers Association
Mississippi Bankers Association
Missouri Bankers Association
Montana Bankers Association
Nebraska Bankers Association
Nevada Bankers Association
New Hampshire Bankers Association
New Jersey Bankers Association
New Mexico Bankers Association
New York Bankers Association
North Carolina Bankers Association

North Dakota Bankers Association
Ohio Bankers League
Oklahoma Bankers Association
Oregon Bankers Association
Pennsylvania Bankers Association
Puerto Rico Bankers Association
Rhode Island Bankers Association
South Carolina Bankers Association
South Dakota Bankers Association
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Virginia Bankers Association
Washington Bankers Association
West Virginia Bankers Association
Wisconsin Bankers Association
Wyoming Bankers Association