



September 9, 2016

Via E-mail to fsb@fsb.org

Secretariat of the Financial Stability Board
c/o Bank for International Settlements
CH-4002
Basel, Switzerland

Re: FSB Peer Review on Corporate Governance

Ladies and Gentlemen:

The Clearing House Association L.L.C.¹ is writing in response to your request for feedback on the implementation of the G20/Organisation for Economic Co-Operation and Development Principles of Corporate Governance (“**OECD Principles**”) as they relate to financial institutions. We understand that the objectives of the review are to: (i) identify effective practices and areas of progress, as well as any gaps and areas of weakness, in how FSB member jurisdictions have applied the Principles to publicly listed, regulated financial institutions, and (ii) inform revisions to the OECD Assessment Methodology used by the World Bank as the basis for country assessments. We also note that the OECD Principles are an important source document for the Basel Committee on Banking Supervision’s Corporate Governance Principles for Banks (“**Basel Governance Principles**”), its industry-specific guidance for internationally active banking organizations.

Among the topics that the FSB invited specific industry comment on in its August 8, 2016 announcement is “*how the corporate governance framework can ensure the*

¹ The Clearing House is a banking association and payments company that is owned by the largest commercial banks and dates back to 1853. The Clearing House Association L.L.C. is a nonpartisan organization that engages in research, analysis, advocacy and litigation focused on financial regulation that supports a safe, sound and competitive banking system. Its affiliate, The Clearing House Payments Company L.L.C., owns and operates core payments system infrastructure in the United States and is currently working to modernize that infrastructure by building a new, ubiquitous, real-time payment system. The Payments Company is the only private-sector ACH and wire operator in the United States, clearing and settling nearly \$2 trillion in U.S. dollar payments each day, representing half of all commercial ACH and wire volume.

strategic guidance of the financial institution, the effective monitoring of management by the board, and the board's accountability, including to the shareholders." These questions, which are among those addressed in Chapter VI of the Principles, are of particular interest to us and have been a focus of our study, discussion and outreach in recent years, including in particular the importance of maintaining the distinction between the roles of the board of directors and management, and the risk to good governance of imposing managerial and administrative responsibilities on the board.

I. TCH's Governance Work

TCH, like the FSB, places great importance on effective corporate governance, and has strived to serve as a thought leader in the area. TCH is committed to working with industry and governmental groups to enhance effective governance at banking organizations, and in this regard TCH has recently published: (i) our Guiding Principles for Enhancing U.S. Banking Organization Corporate Governance (June 2015)² and (ii) The Role of the Board of Directors in Promoting Effective Governance and Safety and Soundness for Large U.S. Banking Organizations (May 2016) (the "**Role of the Board Report**").³ In addition, TCH provided a detailed comment letter on the 2015 proposed revisions to the Basel Governance Principles, and has met with representatives of the Basel Committee and the U.S. bank regulatory agencies to discuss the best ways to advance the cause of good governance at banking organizations.

One critical focus of the TCH publications is a recognition of the distinction between the roles and responsibilities of the board of directors and those of senior management, and the related risks of imposing executive and administrative responsibilities on the board in a way that can undermine the board's independence and effectiveness as an oversight body. Indeed, while TCH's 2016 Role of the Board Report observes that "an informed and actively engaged board is a core element of effective governance," boards should be actively engaged with respect to their core board oversight functions (i.e., rather than actively engaged in the day-to-day management or operations of the organization).

We believe the importance of these distinct roles is inherent in the framework envisioned by the Principles. For example, Section VI of the Principles states that "*the board is chiefly responsible for monitoring managerial performance,*" which reflects that the board itself is not a managerial body. Section VI also provides that "*to effectively fulfil their responsibilities [boards] must be able to exercise objective and independent judgement,*" and that this means "*independence and objectivity with respect to management.*"

² Available at <https://www.theclearinghouse.org/issues/articles/2015/06/20150624-tch-revises-guiding-principles-on-corporate-governance>.

³ Available at <https://www.theclearinghouse.org/issues/articles/2016/05/20160505-tch-publishes-the-role-of-the-board-of-directors-report>.

TCH's 2016 Role of the Board Report referenced above attempts to provide clarity into the appropriate role of the board of directors, as distinct from management, through four recommendations directed to the public sector:

- Recommendation 1: regulatory pronouncements should reflect the performance of the core board functions, as described in that Report.⁴
- Recommendation 2: general recognition by the agencies that a board may utilize board committees to address board responsibilities where a regulatory pronouncement generically uses the term “board.”
- Recommendation 3: the agencies should conduct periodic reviews of the board requirements and standards they promulgate.
- Recommendation 4: the agencies, directors and the industry should participate in a continuing dialogue to advance their common interest in promotion of effective board governance at large U.S. banking organizations.

II. Peer Review of the Governance Frameworks of G20 Member Jurisdictions

As indicated in Recommendation 3 above, individual agencies should conduct periodic reviews of the board requirements and standards they promulgate.⁵ As important as individual agency review is, we believe that review of the corporate governance legal framework (and in particular requirements imposed on the board) on a more holistic, cross-jurisdictional level also has value, because financial institutions are subject to requirements promulgated by multiple authorities – for example, in the United States, state corporate law, federal securities laws, regulations, supervisory guidance and stock exchange listing standards which may overlap/intersect. The FSB peer review is

⁴ These core functions described in the Role of the Board Report are: (i) reviewing and approving the strategic objectives and plans; (ii) monitoring financial performance and condition; (iii) talent management for the CEO and other senior executives; (iv) overseeing the risk management and internal control frameworks, including top-tier policies and plans in fundamental areas; and (v) reinforcing, demonstrating and communicating the “tone at the top” for the values and culture of the organization and overseeing enterprise-wide approaches/programs intended to promote organizational values, culture and reputation.

⁵ We note that the U.S. banking agencies are required under The Economic Growth and Regulatory Paperwork Reduction Act of 1996 (“EGRPRA”) to review existing regulations (including those that impose requirements on the board of directors of banking institutions) at least once every ten years. The purpose of the review is to identify outdated or unnecessary regulations and consider how to reduce regulatory burdens on insured depository institutions while, at the same time, ensuring the safety and soundness of the financial system. The EGRPRA review, however, does not cover agency guidance – which, in our experience, may provide prescriptive guidelines for the roles and responsibilities of the board of directors. Although guidance may not be binding as a matter of law, organizations may follow many of the board-related standards set out in bank examination handbooks and manuals and other supervisory guidance as examiners may apply components of examination guidance as if they are definitive requirements.

focused on governance of publicly traded financial institutions. Other peer reviews by international bodies have provided useful insights on issues relating to corporate governance of financial institutions.⁶

For example, the International Monetary Fund (“IMF”) has conducted banking sector-specific peer review exercises on national implementation of the Basel international principles on supervision.

In particular, the 2015 IMF review of the U.S. bank supervisory framework notes a concern that U.S. bank regulations and guidance often do not clearly distinguish between the board and senior management, leading to possible confusion between the roles. The IMF noted that there were numerous examples in both regulations and in actual supervision where the standard term “board and senior management” was used in situations where good practices would dictate that only one of the two be responsible for the task in question.⁷

III. Expressed Concerns Regarding the Important Distinction Between the Board and Management

Concerns over the imposition of managerial responsibilities on boards of directors has been heightened in recent years as financial regulations have tended to impose an expanded list of specific requirements on the boards. These responsibilities, while each may individually seem reasonable, can in the aggregate result in the board’s finite time and resources being consumed with administrative approval matters at the expense of its ability to perform its critical oversight role.

A number of regulatory and international bodies and their representatives (in addition to the IMF, as noted above) have stressed the importance of maintaining the distinction between the board and management:

- The Group of Thirty has expressed these concerns in its 2012 publication, *Toward Effective Governance of Financial Institutions*,⁸ stating that “*it is essential that the board remain independent and allow management to*

⁶ We note that the FSB’s 2015 Peer Review report, the Thematic Review on Supervisory Frameworks and Approaches for SIBs, focused on, among other things, corporate governance oversight in various jurisdictions. Among the gaps and challenges with regard to U.S. supervision was the multiple layers of regulation that apply to U.S. boards, each with their own standards and requirements (“*U.S. board of directors are held to a number of standards that emanate from different sources. Avoiding duplicative messages to boards is a particular concern of banking supervisors.*”)

⁷ United States Financial Sector Assessment Program, Detailed Assessment of Observance of the Basel Core Principles for Effective Banking Supervision (April 2015), IMF Country Report No. 15/89.

⁸ Available at <http://group30.org/publications/detail/155>.

execute the day-to-day activities of the organization,” that “boards may make a critical mistake if they permit their time and attention to be diverted disproportionately into compliance and advisory activities at the expense of strategy, risk governance, and talent issues,” and that boards should not be driven “to an excessive focus on detailed operational matters that are more properly the purview of management.”

- Superintendent Jeremy Rudin of the Canadian Office of the Superintendent of Financial Institutions (OSFI) recently spoke about the OSFI’s efforts to “*streamline our expectations of boards*” in order to “*create better opportunities for boards to concentrate on the prudential responsibilities that truly matter.*” These efforts are intended to “*prune away some of the growth in the requirements that we have placed on boards of directors of banks...over the years*” to provide “*a more focused and effective approach to governance.*”⁹
- Governor Daniel Tarullo of the U.S. Board of Governors of the Federal Reserve System has noted that it has “*perhaps become a little too reflexive a reaction on the part of regulators to jump from the observation that a regulation is important to the conclusion that the board must certify compliance through its own processes*” and that regulators “*should probably be somewhat more selective in creating the regulatory checklist for board compliance and regular consideration.*”¹⁰
- The preamble to the final version of the U.S. Office of the Comptroller of the Currency’s “heightened standards” guidelines for the risk and corporate governance of certain large national banks notes that “*the OCC did not intend to impose managerial responsibilities on the board of directors, or suggest that the board must guarantee results under the Framework.*”¹¹

These concerns, and other recommendations with regard to bank governance, are discussed in detail in the TCH publications noted above.

IV. Recommendation

In view of the FSB’s statement regarding the scope of the peer review and areas of focus, and the importance of the board’s role in overseeing management, we believe

⁹ Speech by Superintendent Jeremy Rudin at the Global Risk Institute, Toronto (June 14, 2016), available at <http://www.osfi-bsif.gc.ca/Eng/Docs/pl/201608/index.html>.

¹⁰ Speech by Governor Daniel K. Tarullo at the Association of American Law Schools 2014 Midyear Meeting, Washington, D.C. (June 9, 2014), available at <https://www.federalreserve.gov/newsevents/speech/tarullo20140609a.htm>.

¹¹ 12 C.F.R. Part 30, Appendix D – OCC Guidelines Establishing Heightened Standards for Certain Large Insured National Banks, Insured Federal Savings Associations, and Insured Federal Branches). 79 Fed. Reg. at 54537.

that the efforts of the FSB to review and evaluate the supervisory frameworks for corporate governance, including in the peer review, the OECD Assessment Methodology, and any future supplements or revisions to the OECD Principles, should expressly include an evaluation of whether the relevant framework sufficiently distinguishes the roles of the board and senior management, and recognize the dangers to effective governance that arise when the board is misfocused with detailed administrative and managerial responsibilities at the expense of serving its broader oversight function.

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The Clearing House appreciates the opportunity to participate in the FSB's Peer Review process, and appreciates the FSB's efforts to advance the cause of governance at banking organizations. We would be pleased for the opportunity to meet with representatives of the FSB to discuss these comments and the topic of bank governance more broadly if it would be helpful. If the FSB would like additional information regarding these comments, please contact Gregg Rozansky of The Clearing House, at (212) 612-9220 (email: gregg.rozansky@theclearinghouse.org).

Respectfully submitted,

A handwritten signature in black ink that reads "Gregg Rozansky". The signature is fluid and cursive, with a long horizontal stroke at the end.

Managing Director and Senior Associate
General Counsel
The Clearing House Association L.L.C.