State of North Carolina

OFFICE OF THE COMMISSIONER OF BANKS

ROY COOPER
GOVERNOR

KATHERINE M.R. BOSKEN
COMMISSIONER OF BANKS

February 9, 2024

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

Re: Guidelines Establishing Standards for Corporate Governance and Risk Management for Covered Institutions with Total Consolidated Assets of $10 Billion or More

Dear Sir or Madam:

The North Carolina Office of the Commissioner of Banks (NCCOB) appreciates the opportunity to comment on the FDIC's proposed Guidelines Establishing Standards for Corporate Governance and Risk Management for Covered Institutions with Total Consolidated Assets of $10 Billion or More (Guidelines). The NCCOB is the state regulatory body in North Carolina responsible for the regulation of North Carolina's banks and trust institutions, as well as various non-depository financial institutions and mortgage companies that operate in the state. Our mission is to promote and maintain the strength and fairness of the North Carolina financial services marketplace through the supervision and regulation of financial services providers in that marketplace.

The NCCOB is responsible for the supervision of 35 state-chartered banks, with 2,923 branches. As of year-end 2023, total bank assets under supervision were approximately $790 billion. Four North Carolina banks will be covered institutions if the Guidelines take effect, with the remaining banks subject to the FDIC's ability to designate complex institutions.

With respect, the NCCOB encourages the FDIC to rescind these Guidelines in their entirety. While the NCCOB supports strong corporate governance at banks and trust institutions under the agency's supervision, these Guidelines take that principle beyond reasonable boundaries. The Guidelines were promulgated without adequate analysis or support and without engagement with state regulatory partners. The FDIC failed to engage with state regulators and its other regulatory partners to evaluate less onerous ways to achieve strong corporate governance frameworks at insured depository institutions. As a result, the Guidelines impose ambiguous

standards in conflict with state law and are arbitrary and capricious.

The NCCOB's specific concerns with the Guidelines include, but are not limited to:

- ***The Guidelines conflict with corporate governance law in North Carolina by substituting a vague and overbroad stakeholder satisfaction obligation for the more tailored and well-known duties of due care, good faith, and loyalty.***

The Guidelines expand both the roles and the responsibilities of directors in covered institutions. The Guidelines state:

> The board, in supervising the FDIC Covered Institution, should consider the interests of all its stakeholders, including shareholders, depositors, creditors, customers, regulators, and the public.

In expanding the applicable stakeholders boards must consider, the Guidelines conflict with the state law of North Carolina, as well as the laws of several other states with similar provisions.[1] Specifically, the North Carolina General Assembly adopted a familiar director responsibility framework that has been in operation for the past 34 years. The North Carolina Business Corporation Act, upon which all NC state-chartered banks are based, sets forth the applicable duties:

> A director shall discharge the director's duties as a director, including the director's duties as a member of a committee or subcommittee, in accordance with all of the following:
>
> (1) In good faith.
>
> (2) With the care an ordinarily prudent person in a like position would exercise under similar circumstances.
>
> (3) In a manner the director reasonably believes to be in the best interests of the corporation.

N.C. Gen. Stat. § 55-8-30(a) (2023). The case law around this standard has been more than adequately developed and is well-understood by bank directors in North Carolina. The Guidelines propose to displace this jurisprudence with a poorly conceived notion of stakeholder satisfaction, without adequate explanation or substitutes for the state-law standard.

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[1] North Carolina's Business Corporations Act is patterned after the 1984 Revised Model Business Corporation Act, with updates as needed to conform to the Model Act. This is significant because several North Carolina bank holding companies (as opposed to the insured depository institutions) are organized under the laws of the State of Delaware, and board members are subject to the fiduciary duties imposed by Delaware state law. Because Delaware utilizes the same framework that North Carolina has adopted for director duties, these obligations are, for practical purposes, the same at the holding company and bank levels. Under the Guidelines, however, director obligations at the bank and bank holding company level will legally diverge, with the peculiar result that directors at the holding company level will have less onerous obligations than directors at the bank level.

The Guidelines further impose an overbroad standard whereby bank directors must please all comers, with its inclusion of the "public." Banks in North Carolina regularly consider the business needs of consumers, but imposing this consideration as a legal obligation through the corporate governance framework goes too far. Covering such a broad class weakens corporate governance by prioritizing groups to which the institution owes no legal duty under state laws. The narrow, and often antagonistic, interests of such a broad group of stakeholders are likely to conflict with the institution's business plan and the ability of the institution to engage in safe and sound banking practices.

Moreover, under the Guidelines, it is not possible to predict how the FDIC will view, quantify, or prioritize the interests of this nebulous group of stakeholders. The proposal offers no guidance to bank directors on how those interests should be quantified, or on the consequences of prioritizing certain interests over those of disaffected stakeholders. Given the current state of public discourse, it is obvious that there is no clear agreement on what precisely is in the best interests of the American public. In stark contrast, there is a body of jurisprudence devoted to assessing and managing organizational interests, which is appropriately modified for certain categories of bank directors (i.e. directors at very large banks) under the current safety and soundness framework.

Unlike the proposed Guidelines, state corporate governance requirements have refined director duties to focus on a specific, tailored set of interests, with rationally defined targets. The proposed Guidelines do not address the myriad other scenarios that will arise from the newly expanded stakeholder duties and should be rescinded for this reason alone.

- ***The Guidelines conflate director and management roles, which will increase legal risk and give rise to competing standards in litigation.***

The Guidelines prescribe a number of granular tasks for bank directors that are more traditionally performed by management. Prior guidance from the FDIC has recognized the distinction between the board and management's role, including the 1988 Pocket Guide for Directors, the 1992 Statement Concerning the Responsibilities of Bank Directors and Officers, the 2005 Corporate Codes of Conduct, and the 2018 Supervisory Insights resource for community bank directors. Because the Guidelines are promulgated under Section 39, they will be the first FDIC governance framework with the force of administrative law behind it, which will create legal risk as bank boards navigate a complex and shifting relationship with their management teams. Moreover, it is likely that these standards will be viewed by many "stakeholders" as persuasive legal duties now imposed on bank directors.

The prescriptive tasks in the Guidelines will detract from the board's duty to establish the strategic direction of the bank and oversee its execution by management. Several of the FDIC requirements are better performed by professional management teams, whose day-to-day responsibilities include managing processes, systems, and people. As any person who has served on a board knows, the volume of materials presented in board packages can be overwhelming.

Adding 91,375 hours[2] worth of annual burden to board packages is going to fatigue board members and inevitably lead to errors. Adding an additional obligation of 13,680 hours per quarter (54,720 hours per year) would deter most rational people from board service.

Finally, this conflation of responsibilities among management and directors will erode good corporate governance. The involvement of board committees and directors in processes and procedures will compromise the independent oversight of the board and undermine the board's ability to effectively challenge itself and management. Minor mistakes made as a result of the intensely granular requirements imposed on bank boards will spawn litigation at the first sign that the board did or did not do something in compliance with the stakeholder satisfaction standard.[3]

Contrary to the FDIC's assertion that the proposal's benefits outweigh its costs, the Guidelines will impair the ability of covered institutions to attract qualified candidates for board service.

- ***The Guidelines create untenable board membership restrictions and requirements.***

The Guidelines propose there should be at least a majority of independent directors on the boards of covered institutions. The Guidelines further state:

> An independent director is generally a director that is (a) not a principal, member, officer, or employee of the institution, and (b) not a principal, member, director, officer, or employee of any affiliate or principal shareholder of the institution.

Although corporate governance has evolved in the 21st century, it is still common (and useful) to have members of senior management serve on the board of directors, and have directors serve on both the holding company and bank boards. While the Guidelines do not specifically prohibit service by senior management, the majority independence requirement will in practice alter the composition of some well-functioning boards.

Similarly, there is substantial ambiguity as to when whole boards will need to be reconstituted because of restrictions on overlapping board service at the holding company and bank levels. An explanatory footnote in the Guidelines continues:

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[2] The Guidelines "would compel covered institutions to expend 91,375 labor hours in the first year, and 90,365 labor hours each additional year, to comply with the recordkeeping, reporting, and disclosure requirements." Guidelines at 70,398. These obligations are broken down into annual, quarterly, one-time, and occasional obligations, with the quarterly obligation summing to 13,680 hours per quarter. Although the Guidelines note that a covered institution with "strong corporate governance and risk management programs may not need to significantly increase the number of hours it spends on [governance] to comply with the proposed Guidelines," the Guidelines estimate annual costs of around $12.6 million annually for compliance, all in an effort to "reduc[e] the likelihood of failure." *Id*. at 70,399-70,402. Reducing the likelihood of disorderly outcomes and panic in the banking sector is a laudable goal, and one every regulator should strive to achieve. The Guidelines, however, appear to work at cross purposes to that goal.

[3] These "mistakes" may even be compliant with the business judgment rule but still create litigation risk when the board's decision is inconsistent with stakeholders' or management's judgment.

> In instances where an affiliate or a principal shareholder is a holding company, and the holding company conducts limited or no additional business operations outside the institution, an independent director of the holding company may also be an independent director of the institution, as long as they are not a principal, member, director, officer, or employee of any other institution or holding company affiliates.

The Guidelines do not define "limited or no additional" business operations, and it is unclear if associated subsidiaries will qualify in this definition. In many banks today, existing boards have shared directors between the holding company and the bank, without governance issues. The Guidelines fail to justify this significant deviation from current practice.

Finally, this new requirement exceeds any board restrictions at the proposed size threshold from the other federal regulators. It also substantially deviates from the established definition of independence. Without further clarification, this language in the Guidelines is overbroad and ambiguous, and will obligate any institution crossing the asset threshold[4] to consider sweeping changes to its boards of directors.

- ***The Guidelines can be arbitrarily applied below the asset threshold, if the FDIC determines the bank is complex or high risk.***

The Guidelines assert that they may be applied in whole or in part to institutions below the $10 billion asset threshold, without clearly setting a standard for application. The Guidelines state only that they will apply, if the FDIC determines a smaller bank is "highly complex or present[s] heightened risk." The terms "complex" and "high risk" are not defined, and currently appear to follow the standard for pornography: You know it when you see it.[5]

It is unclear how and under what circumstances the guidelines will apply to institutions below the stated asset threshold, or how FDIC staff will interpret "complex" and "high risk" now or in the future. Board members and State supervisors will be forced to question whether specific business models will expose smaller banks to these new governance requirements, which may only be disclosed in the ordinary course of examinations. This lack of certainty in the evolving market for financial services will be detrimental to banking in the U.S., and will lead to activities moving outside of and away from the regulated banking sector.

In the absence of any true asset threshold, the Guidelines attempt to arrogate unfettered authority to the FDIC to apply these rules to any institution, regardless of asset size. Without additional analysis, definitions, and guardrails, the Guidelines ought to be unenforceable.

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[4] As described in the next bullet, banks may be affected for entering a new line of business that results in the complex designation, whether they meet the asset threshold or not.

[5] *Jacobellis v. Ohio*, 378 U.S. 184, 197 (1964) (Stewart, J., concur.)

- ***NCCOB, as the chartering authority and primary regulator of North Carolina-chartered banks, supports CSBS's comment letter.***

In addition to the concerns noted above, the NCCOB notes its alignment with and support for the concerns raised in the Conference of State Bank Supervisors' comment letter. State regulators, as the chartering authorities of the proposed covered institutions, are vital partners in the American regulatory system. State regulator input should be considered for any fundamental change to the supervisory expectations for banks and holding companies. This is especially pertinent when the agencies have shared supervisory authority and *where the applicable legal framework is based on state law*.

Conclusion

The stated goal of the Guidelines is "to raise the FDIC's standards for corporate governance, risk management, and control to help ensure these larger institutions effectively anticipate, evaluate, and mitigate the risks they face." Unfortunately, the vague and overbroad nature of some portions and overly prescriptive nature of other proposed requirements are more likely to weaken corporate governance and risk management. Blurring the lines between applicable state law requirements and federal Guidelines, establishing new duties and enforceable expectations on board members, and conflating the roles of the board and management will undoubtedly lead to increased costs and risks to covered financial institutions.

As the chartering authority and primary regulator of North Carolina banks, the NCCOB believes that strong corporate governance and risk management practices are vitally important. The Guidelines miss the mark in effectively achieving this goal and the NCCOB strongly encourages the FDIC to rescind these Guidelines in their entirety.

Sincerely,

Katherine M.R. Bosken
Commissioner of Banks

cc: Stephanie White, Chief Deputy Commissioner
Eugene St. Andrews, Deputy Commissioner for Depository Supervision
Kristin Rice, Deputy Commissioner for Legal Affairs
Sally-Ann Gupta, Public Information Office and Legislative Liaison