November 27, 2023

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

Attention: Comments/Legal OES (RIN 3064–AF94)

To Mr. Sheesley and members of the Corporation:

I very much appreciate the opportunity to comment on the proposed Guidelines Establishing Standards for Corporate Governance and Risk Management for Covered Institutions With Total Consolidated Assets of $10 Billion or More. I strongly support the proposed rule.

Beyond the deference that is earned by a regulatory body's expertise, the FDIC is entitled to an additional layer of deference because it is not just an overseer; it is a participant. And no entity is more dedicated to risk-benefit assessment than an insurer. If it was operating solely as a private insurance company, it would insist on the provisions of this proposed rule in its contractual agreements with the insured institutions.

In other words, the corporate governance rules outlined in the proposed rule are cost-effective, essential for mitigating risk, and well-established as best practice[i] for public corporations not just in the US but in other economies as well. Indeed, there is not a single corporate governance

best practices list that does not include these provisions. Your proposal underscores this by pointing out:

> An effective governance framework is necessary for an insured depository institution to remain profitable, competitive, and resilient through changing economic and market conditions. The board of directors serves a critical role in maintaining an insured depository institution's safety and soundness and continued financial and operational resilience.
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> The FDIC observed during the 2008 financial crisis and more recent bank failures in 2023 that **financial institutions with poor corporate governance and risk management practices were more likely to fail**….
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> The FDIC expects all FDIC-supervised institutions to have good corporate governance, including the key component of an active and involved board protecting the interests of the institution rather than the interests of the parent or affiliate of the institution. The proposed Guidelines for covered institutions emphasize **the importance of developing a strategic plan and risk management policies** and procedures and selecting and supervising senior management so that a covered institution will operate in a safe and sound manner. The proposed Guidelines also emphasize the importance for the board and management to **adopt a code of ethics, to demonstrate high ethical standards in the covered institutions' operations, and to act to ensure the covered institution and its employees adhere to applicable laws and regulations**, including consumer protection laws and regulations, and the Community Reinvestment Act. [emphasis added and footnotes omitted]

The fundamental element of capitalism is minimizing agency costs. No one outside the enterprise will risk capital unless the system assures the money will be used for long-term returns to benefit investors and not for the benefit of insiders. We give providers of capital that assurance through a combination of disclosure and structural requirements and accountability through market and law-and-regulation-based provisions. A cornerstone of that assurance comes from the board of directors. Investors must be able to rely on the board to resolve conflicts of interest in their favor. That includes executive compensation – insiders generally prefer less variability than investors – often a key indicator of poor performance risk and a key indicator of an ineffective board as well.

The board is also there to manage risk, and that includes overseeing compliance, audit and accounting, development of strategy, and ethics. People often misunderstand the importance of ethics, thinking it has something to do with the Golden Rule and singing hymns. But ethics is really just another element of risk management. Over and over, we have seen major corporations fail due to ethics violations, from Enron (which got its board to sign off on a waiver of the company's ethics rules) to FTX (which did not have a CFO, board, or compliance officer and which lied about its accessing of customer funds).

Markets do not run on money; they run on trust. The FDIC's own findings on the failure of the Republic Bank included "a loss of market and depositor confidence, resulting in a bank run." Everything FDIC is proposing in this rule will increase confidence in the financial institutions, and that confidence will be earned. Therefore, with regard to the specific questions asked by FDIC about the proposed rules, I do not believe there is any reason to limit the imposition of these requirements based on the size of the institution. Every corporation with outside investors should have a majority of independent directors, a risk committee, and a code of ethics, and should comply with other laws already in place. In every situation, those requirements are cost-effective. At a minimum, I would impose a "comply-or-explain" requirement on the smaller institutions. This option is raised in your fourth question, about a possible exemption for "risk and complexity." Risk and complexity are the reason for these rules, not a reason to waive them. An exemption should only be granted in the rare cases where a covered institution can show that it is meeting the goals of risk mitigation and accountability with a better system. This will encourage innovation instead of excusing them without this kind of demonstrable proof, which would just increase risk. Similarly, the fourteenth question, is a reminder that whenever possible, rules should be based on performance standards rather than design (structural) standards. There should always be incentives to come up with better, less burdensome, and less expensive ways to achieve the goals, but not to evade them.

The proposal asks what other governance improvements commenters would recommend. I would recommend that directors be allowed to serve only if they get more than 50 percent of the shareholder vote. Since insiders generally control the nomination process and they run unopposed, a "withhold" vote is the only way for shareholders to show their disapproval. Legally, they may still serve if they get even a single vote. But if a majority of shareholders decline to approve them, they should not be allowed to serve as directors. The term "independent director" may need additional clarification. It should mean someone who has never been an employee or service provider and has no family or other connections or affiliations through for-profit, non-profit, or other organizations with the institution's executives or the other board members.

I have noticed, in recent years, that there are a number of comments on proposed rules that are submitted by groups or individuals that appear to be independent but are in reality funded by industry sources or by undisclosed insiders. I hope the staff will review the funders of those who comment. I especially hope the staff will be skeptical about any un-audited, un-verified claims of the expense of complying with the rule.

I want to emphasize that I am writing entirely on my own behalf as a long-time observer and scholar of corporate governance[ii]. I use the letterhead of my company for purposes of identification, but this comment expresses my views only. Neither I nor my partners have any connection to or revenue from FDIC-insured companies and none of our clients will benefit in any way other than the incidental benefits for all shareholders. Again, I welcome the

opportunity to comment, and I am happy to meet with staff or provide further information if it would be helpful.

Sincerely,

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[i] https://www.wlrk.com/webdocs/wlrknew/AttorneyPubs/WLRK.23799.14.pdf, https://www.cii.org/corp_gov_policies, https://www.perkinscoie.com/en/pch-chapter-9.html,

[ii] I was co-founder, the first general counsel and the second president of Institutional Shareholder Services, and, with the same partners, a principal of the governance activist LENS Fund, a co-founder and Chair of The Corporate Library (later GMI Ratings and now a division of MSCI), and now Vice Chair of ValueEdge Advisors, a corporate governance consulting firm. In every case, we have worked exclusively on behalf of shareholders. With my long-time business partner Robert A.G. Monks, I have written several books about corporate governance, including five editions of an MBA textbook by that title. With him and on my own I have written over 200 articles about corporate governance with op-eds in the NY Times, the Wall Street Journal, and USA Today, and I taught Executive MBA students for five years at George Mason University.