December 14, 2023

Federal Deposit Insurance Corporation
550 17th Street NW
Washington, D.C. 20429

By Email: comments@FDIC.gov (subject line: RIN 3064–AF94)

Re: Proposed Corporate Governance and Risk Management Rules

Dear Sirs and Madams:

The Society for Corporate Governance (the "Society") respectfully submits this comment letter about the proposed rulemaking of the Federal Deposit Insurance Corporation (the "FDIC") that would add to the FDIC's safety and soundness guidelines extensive and prescriptive corporate governance rules and risk management directives for certain financial institutions (the "Proposal").[1] We are aware that the FDIC's initial December 2023 deadline for submissions of comment letters has been extended, at the request of numerous organizations, until February 2024. Given the Proposal's breadth and the problems we identify below, however, we are submitting this letter close to the original deadline to contribute most constructively to the public comment process.

Founded in 1946, the Society is a professional membership association of more than 3,700 corporate and assistant secretaries, in-house counsel, outside counsel, and other governance professionals who serve approximately 1,600 entities, including 1,000 public companies of almost every size and industry. The Society seeks to be a positive force for responsible corporate governance through education, collaboration, and advocacy. Our organization has over 75 years of experience empowering professionals to shape and advance corporate governance within their organizations.

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[1] FDIC, Guidelines Establishing Standards for Corporate Governance and Risk Management for Covered Institutions with Total Consolidated Assets of $10 Billion or More, 88 Fed. Reg. 70391 (October 11, 2023). The title's wording—"*guidelines*" rather than "*regulations*"—could suggest to inexpert readers that the Proposal is intended to provide merely precatory or supervisory guidance. However, the Proposal is based on Section 39 of the Federal Deposit Insurance Act, which authorizes federal banking agencies to adopt enforceable guidelines that prescribe safety and soundness standards for insured depository institutions. 12 U.S.C. § 1831p-1(e). An institution that fails to comply with such guidelines may be subject to a range of corrective and enforcement actions. *See* FDIC*, RMS Manual of Examination Policies* § 15.1-12 (July 2016). Therefore, the Proposal, if adopted, would have the force of a regulation.

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The Society and its members work closely with boards of directors and officers to establish procedures to promote effective governance, compliance with laws, and board awareness of material risks. The Society also participates actively in the formulation of public policy and law, gaining deep experience with the statutory and judicial administrative procedures that apply to agency rulemaking. As a large resourceful group of corporate governance professionals, we are uniquely positioned to help the FDIC and its staff in these specialized areas.

The FDIC has a legitimate role and responsibility in supervising and regulating financial institutions within its statutory mandate and faces both challenges and trade-offs in designing and implementing applicable standards. The Society appreciates the FDIC's mission and values, such as protecting depositors, promoting public confidence, and fostering financial stability. The Society agrees with the FDIC on the importance of tailored and risk-based supervision, the value of board oversight and management accountability, and the need for continuous improvement and adaptation in governance and risk management. We are concerned, however, that the Proposal's one-type-fits-all and prescriptive approach would result in less effective corporate governance. We therefore submit in this comment letter alternative approaches that would advance those goals more effectively and efficiently.

Executive Summary

Our letter is organized as follows.

First, we identify 10 *general thematic problems* with the Proposal, listed below, and suggest ways to avoid them. The Proposal:

(1) misconstrues and conflates board and management roles,

(2) states unrealistic expectations of boards as *insurers* of certain outcomes,

(3) lacks appreciation for the variation among financial institutions in structure and business lines,

(4) is inconsistent with or disregards other established corporate law and governance authorities,

(5) is not supported by any demonstrated need,

(6) would impose overly burdensome costs,

(7) promises only illusory benefits,

(8) violates the Administrative Procedure Act,

(9) overlooks Supreme Court jurisprudence, and

(10) overlooks superior alternative approaches.

Second, we identify a dozen *specific problems* in the Proposal, listed below, and suggest ways to correct them. The Proposal:

(1) neglects the variety of corporate governance models that exist in the U.S.,

(2) omits the most important sources of binding corporate governance in the U.S.,

(3) provides misplaced suggestions to eliminate redundant director skills,

(4) assumes improperly that diversity and a novel concept of independence are more important director qualifications than industry experience or institutional knowledge,

(5-8) suggests unrealistic and infeasible provisions that would make directors responsible for:

- culture and work environments,
- operating policies,
- developing ethics codes,
- control programs and policies,

(9) lacks context for mandates of specific board committees,

(10) provides dubious value for mandating proposed mission statements,

(11) proposes a problematic legal compliance mandate on boards, and

(12) calls for an arbitrary and automatic application of these mandates.

Finally, we conclude by answering three questions the FDIC posed for comment in its notice of this rulemaking, stating that the Proposal:

(1) is overly prescriptive,

(2) blurs the distinction between boards and managers, and

(3) fails to recognize the overly burdensome costs it would impose on banks and the financial system.

General Thematic Problems

1. Role Confusion between Directors and Officers. The Proposal *misconstrues and conflates the roles* of boards of directors and management. It frequently contemplates imposing managerial duties on boards that are the responsibility and prerogative of management and that boards are neither capable nor positioned to perform. We note numerous instances of such confusion—including making directors responsible for corporate culture, work environments, operating policies, and developing ethics code—and suggest that they all be deleted or corrected.[2]

2. Unrealistic Expectations under the "Ensure" Standard. The Proposal sets forth *unrealistic expectations and imposes duties* on boards to "ensure"[3] certain events or outcomes are achieved or avoided, which boards and companies are simply not capable of "ensuring." The Proposal uses the word "ensure" nearly 70 times. We are not aware of any existing law or regulation concerning corporate governance that establishes such unrealistic expectations.

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[2] For concise authoritative treatments of the distinct roles boards and managers play and the importance of respecting distinctions, see National Association of Corporate Directors, *The Role of the Board v. The Role of Management* (Feb. 2022) (primer on fundamentals); Linda Liu, Robyn Bew & Friso der Oord, *Building Board-Management Dynamics to Withstand a Crisis: Addressing the Fault Lines*, McKinsey & NACD (Sept. 2019) (why fundamentals are critical to effective corporate governance).

[3] The Oxford English Dictionary defines the term "ensure" as "[t]o make certain the occurrence or arrival of (an event) or the attainment of (a result); = assure, v. 5." *Oxford English Dictionary*, Ensure, https://www.oed.com /dictionary/?scope=Entries&q=ensure (last visited Dec. 11, 2023).

In contrast to the Proposal, we note other sources of corporate governance laws/regulations that reflect more realistic expectations. First, in the FDIC's own enforcement actions and under general banking law, safety and soundness violations occur when a person's actions or inactions imprudently create "*an abnormal risk of loss*"—the law does not demand action that "ensures no risk of loss."[4] Second, under corporate law, fiduciary duty violations occur when a director fails to attempt in good faith to assure that company management maintain an adequate system of internal controls to promote compliance with law—the law does not require action that "ensures" any result.[5]

Consequences of the Proposal would chiefly be to hold directors personally responsible and liable for the occurrence of events or outcomes that are due to unforeseeable circumstances beyond anyone's reasonable control. This described environment would dramatically reduce the pool of directors willing to serve FDIC-insured banks and heighten financial burdens on these banks. Sharp increases in compensation and D&O insurance costs needed to attract and retain capable directors would be especially daunting for smaller covered institutions. We note many instances of such unreasonable expectations and suggest that they all be deleted.

3. <u>Incorrect Assumption of Institutional Heterogeneity</u>. The 57 initially affected banks *are not homogenous*. With respect to size: by assets, they range from $10 billion to $500 billion and by annual net income from $50 million to $6 billion. They vary greatly by state of incorporation (the 57 banks are incorporated in nearly 30 different jurisdictions),[6] stock ownership and listing (a mix of NYSE and NASDAQ and privately held), lines of business, customer concentration, employee base, business histories, markets and geographies served, leadership context, cultures, and innumerable other factors, both tangible and intangible.

Yet the Proposal's governance and control rules are presented as singularly optimal practices (said to represent "strong" or "good" governance) while ignoring the specifics of these unique organizations.[7] Such a one-type-fits-all approach is inconsistent with the venerable risk-

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[4] S*ee*, *e.g.*, *In the Matter of Burgess*, FDIC 14-0307e, 2022 WL 4598597, at *36 (FDIC Sept. 16, 2022) (quoting the standard as having "long guided federal banking agencies, including the FDIC").

[5] *See, e.g., Constr. Indus. Laborers Pension Fund v. Bingle,* No. 2021-940, 2022 WL 4102492, at *6 (Del. Ch. Sept. 6, 2022), *aff'd*, 297 A.3d 1083 (Del. 2023).

[6] The states of incorporation represented by these 57 banks are California (7), Utah (6), Texas (5), Pennsylvania (4), New York (4), Massachusetts (4), Washington (3), North Carolina (3), Indiana (2), Georgia (2), Mississippi (2), Oklahoma (2), New Jersey (2), Illinois (2), Delaware (2), Alabama (2), Oregon (1), Montana (1), Nevada (1), Hawaii (1), Puerto Rico (1), West Virginia (1), Virginia (1), Arkansas (1), Iowa (1), Missouri (1), North Dakota (1), Colorado (1), and Florida (1).

[7] The Proposal relies heavily on abstract or subjective concepts that have limited utility in regulation, especially phrases such as "strong" governance or "good" governance. Such phrases are sometimes used in the academic literature and by non-governmental organizations to classify aspects of comparative governance such as the range and protection of shareholder rights in different countries. *E.g*., Paul A. Gompers, *et al.*, *Corporate Governance and Equity Prices*, 118 Q. J. Econ. 107, 114-118 (2003); Rafael La Porta, *et al., Investor Protection and Corporate Valuation*, 57 J. Fin. 1147 (2002). But there are no singular practices that universally and permanently render governance "strong" or "good." Corporate governance is only effective when governance practices are tailored to specific circumstances and adapted as circumstances change. *See* Tom Baker & Sean J. Griffith, *Predicting Corporate Governance Risk: Evidence from the Directors' and Officers' Liability Insurance Market*, 74 U. Chi. L. Rev. 487, 487 (2007) ("what

based approach to bank supervision.[8] Given the heterogenous nature of the banks and the corresponding importance of tailored rather than blanket governance guidelines, we suggest rethinking the Proposal's one-type-fits-all approach to corporate governance.

4. Inconsistencies and Disregard of Authorities. The Proposal is *inconsistent* with the FDIC's mission and supervisory approach (and those of other banking agencies), which is to promote safety and soundness by tailoring supervision to risk-based, institution-specific features. The Proposal imposes blanket rules for all affected institutions, without regard to their significant differences as noted above.

The Proposal is, in some instances, *inconsistent* with other regulations. For example, the Proposal appears to indicate that a director of a bank board is generally not independent if that director also serves on the bank's holding company board. Overlapping board memberships are typical among banking institutions and do not run afoul of independence rules established by the OCC,[9] the Federal Reserve, the FDIC's own independence rules,[10] or the context-based approach followed by most corporate governance authorities such as in state corporation law,[11] federal securities regulations,[12] or stock exchange listing manuals.[13]

The Proposal disregards state law, prescribing a rigid framework without appreciating the value and importance of state laws it would preempt. For example, Delaware corporate law has developed a rich and respected standard of oversight duties under its well-known *Caremark* standard with recent refinements by the Delaware Supreme Court, which is quite different from the mandates of the Proposal.[14] The Proposal disregards comity for variation in state law and the fact that states take varied approaches to corporate governance. To provide a well-known example,

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matters in corporate governance are 'deep governance' variables such as 'culture' and 'character,' rather than the formal governance structures"). As an example, Enron Corporation's corporate governance features checked all the boxes of "strong" and "good" governance—yet it was a galactic fraud that cost Americans many billions of dollars. We suggest that the FDIC focus not on abstract and subjective concepts but on the specific concrete circumstances and contexts of each institution so that each institution is given the flexibility to determine a set of governance arrangements that will be effective for that institution.

[8] *See* FDIC, Financial Institution Letter, *Risk-Focused, Forward-Looking Safety and Soundness Supervision* (Aug. 27, 2019), https://www.fdic.gov/news/financial-institution-letters/2019/fil19047.html.

[9] *See* 12 C.F.R. Pt. 30, Appendix D; see also OCC, *Corporate and Risk Governance* 24 (July 2019).

[10] *See* 12 C.F.R. Pt. 363, Appendix A.

[11] *See*, *e.g.*, *In re Oracle Corp. Derivative Litig*., 824 A.2d 917, 937-939 (Del. Ch. 2003); *In re MFW Shareholders Litig*., 67 A.3d 496, 509-510 (Del. Ch. 2013), *aff'd sub nom. Kahn v. M&F Worldwide Corp*., 88 A.3d 635 (Del. 2014).

[12] *See* 17 C.F.R. 229.407(a).

[13] *See* New York Stock Exchange, *New York Stock Exchange Listed Company Manual*, § 303A.02 Independence Tests (2013); Nasdaq, Rule 5606, Board Diversity Disclosure (2009); Nasdaq, IM-5605, Definitions of Independence–Rule 5605(a)(2) (2009).

[14] *See Marchand v. Barnhill*, 212 A.3d 805, 809 (Del. 2019*); In re Caremark Int'l Inc. Deriv. Litig*., 698 A.2d 959 (Del. Ch. 1996). Courts in other states often look for guidance to Delaware corporate law, including its *Caremark* jurisprudence. *E.g*., *Kanter v. Reed*, 92 Cal. App. 5th 191, 210 (2023); *In re Abbott Lab'ys Derivative S'holders Litig*, 325 F.3d 795, 805 (7th Cir. 2003) (applying Illinois law guided by Delaware law, including *Caremark*).

Texas corporate law contains a distinctive director "duty of obedience" under which directors' actions may not veer outside authorized law.[15]

5. Unnecessary. The Proposal is *unnecessary* for many reasons. First, most FDIC-regulated banks are small and not complex. Only four FDIC-regulated banks have more than $100 billion in total assets, and most of the banks that would be subject to the Proposal have less than $30 billion in total assets. Few FDIC-regulated banks engage in international activities, markets/trading activities, or extensive nonbank activities. Almost all institutions with large or more complex risk profiles are heavily regulated as national banks by the OCC or as holding companies by the Federal Reserve.

The Proposal seems to ignore the fact that the 57 banks are already shaping their practices due to the oversight, regulation, and operational expectations by not only the FDIC, but by the Federal Reserve, state banking and corporation laws, and, for many, federal securities regulations and stock exchange listing rules. Such practices are further influenced by ordained practices championed by institutional investors, proxy advisors, and others.

Moreover, the Proposal does not demonstrate any nexus between bank failures (of recent vintage or historically) and specific governance changes in the Proposal (such as corporate constituencies, director qualifications, committee structures, or mission statements). In the case of recent bank failures, notably, authorities have attributed them not to governance problems, but to management's business decision-making errors, such as an excessively concentrated business model, as well as other extraneous forces such as social media and supervision issues.[16]

6. Overly Burdensome. The Proposal is overly *burdensome*, and the FDIC has overlooked significant costs associated with implementing it. The FDIC estimates compliance costs of nearly $13 million annually, implying these are small in the scheme of things: "less than 0.03 percent of annual noninterest expense for all covered institutions." 88 Fed. Reg. at 70398. While that sounds low, it is illuminating to consider other metrics and contexts. For instance, for covered banks earning net income of $13 million or less, the proposed rules would render them unprofitable; for those earning $100 million or less, the Proposal erodes more than 10% of profits.

More importantly, the estimate grossly understates the likely costs of compliance for most covered institutions. The underestimate is partly due to the low hourly rates the Proposal assumes for professional services of "executives, lawyers and financial analysts," which at $139.33/hour are unrealistic and significantly below market rates and the rates used by other federal agencies

[15] Other examples include variation in the strength of the business judgment rule, from relatively strong deference to directors in Delaware to less deferential in California and New York, to variation in rights of immunity of directors from personal liability, from relatively strong in Nevada to weak or optional in Florida and Maryland.

[16] *See*, *e.g.*, *Recent Bank Failures and the Federal Regulatory Response*: *Hearing Before the S. Comm. On Banking, Housing, and Urban Affairs*, 108th Cong. (2023) (statement of Michael S. Barr, Vice Chair for Supervision, Board of Governors of the Federal Reserve System), https://bit.ly/3GCUC0m ("SVB's failure is a textbook case of mismanagement. The bank had a concentrated business model, serving the technology and venture capital sector. It also grew exceedingly quickly, tripling in asset size between 2019 and 2022.").

with oversight authority over many of the covered institutions.[17] It is difficult to estimate the likely number of hours required—pegged in the Proposal at about 91,000—but the foregoing underestimation warrants concern that the Proposal also underestimates required hours by a similar order of magnitude.[18]

The Proposal acknowledges that additional costs, which may be significant and which the FDIC has not sought to quantify or estimate, would be incurred, "such as hiring additional staff and changes to internal systems and processes." 88 Fed. Reg. at 70398. Adding these costs would not only impair the profitability of many covered banks, but also threaten the solvency of some.

Even worse, the Proposal ignores many other obvious and substantial costs altogether, including:

- the costs to recruit, train, and retain new directors, which can reach six figures per board seat;
- the costs of mounting additional and duplicative board and committee agendas, materials, meetings, and minutes (*i.e.*, for a holding company versus its banking subsidiary) to respond to the independence rules discussed above;
- the costs of increased director compensation necessitated by the expanded duties and personal liability and reputational risks;[19]
- the costs of shrinking the pool of director candidates willing to serve under the expanded duties and greater risks;[20]
- the costs of higher D&O insurance premiums, which are very likely given increased liability risks;[21]

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[17] 88 Fed. Reg. at 70398 and n.32. Starting in 2022, the Securities and Exchange Commission (the "SEC") has estimated the market rate for outside professionals to average $600 per hour. *See*, *e.g*., Listing Standards for Recovery of Erroneously Awarded Compensation, 87 Fed. Reg. 73076, 73133 (Oct. 26, 2022).

[18] The Proposal would require many small, community banks to establish and operate extensive, formal risk management frameworks. The financial cost and time required by the board and management to stand up such programs, build relevant systems, and sustain them would impose a significant burden on affected banks. Even more significantly, many affected banks are located outside of major metropolitan areas, making it difficult to recruit and retain talent with the specialized experience needed to comply with the Proposal.

[19] Mariya N. Ivanova, *et al*., *Does More Liability Mean More Responsibility? The Effects of Director Liability in Financial Institutions* (working paper 2022), https://bit.ly/3RDaJBp (following increased regulatory requirements on financial institution boards, new directors were less experienced but better paid); Eliezer M. Fich & Anil Shivdasani, *The impact of Stock-option Compensation for Outside Directors on Firm Value*, 78 J. Bus. 2229, 2231-2232 (2005) (expansion of stock-based compensation for directors interpreted as a response to heightened demands and risks imposed on outside directors).

[20] Eliezer M. Fich & Anil Shivdasani, *Financial Fraud, Director Reputation, and Shareholder Wealth*, 86 J. Fin. Econ. 306, 309-310 (2007) (increased regulation may increase the reputational and legal risks of serving on public company boards and thus reduce the supply of qualified outside directors); Sukesh Patro, *et al., Determinants of the Size and Structure of Corporate Boards: 1935–2000*, 38 Fin. Mgmt. 747 (2009) (same).

[21] *See*, *e.g*., Daniel E. Rhynhart, *After the S&L Crisis: The Future of Regulatory Exclusions in Bank Directors' and Officers' Insurance and Professional Liability Insurance Policies*, 15 Ann. Rev. Banking L.

- the opportunity costs of directors and officers meeting the prescribed managerial and procedural functions rather than performing value-added services such as business development, constituent relations, or networking and stewardship;[22] and
- the potential costs from unintended collateral risks resulting from imposing uniform new rules on an existing institutional culture (as occurred at AIG, fueling the financial crisis in 2008).[23]

7. Illusory Benefits. For all that, the FDIC acknowledges that it simply does not know how to estimate the benefits of the extensive and intrusive rules it is proposing. The Proposal states:

> The FDIC does not have access to information that would enable a quantitative estimate of the benefits of the proposed rule. . . . The FDIC believes that adoption of the proposed Guidelines would benefit covered institutions by establishing clear expectations for covered institutions and strengthening corporate governance and risk management.

88 Fed. Reg. at 70398.

8. Administrative Procedure Act. We believe that many of the Proposal's elements fail to satisfy the requirements of the Administrative Procedure Act (the "APA").[24] In particular, the APA prohibits rulemakings that are: (a) not within an agency's statutory authority; (b) unsupported by substantial evidence;[25] (c) arbitrary, capricious, or an abuse of discretion; and (d) not in accordance with law.

537, 570 (1996) (noting that stringent regulatory responses to banking crisis led to a liability insurance crisis); John E. Core, *On the Corporate Demand for Directors' and Officers' Insurance*, J. Risk & Ins. 63, 64 (1997).

[22] Olubunmi Faleye, *et al*., *The Costs of Intense Board Monitoring*, J. Fin. Econ. 160, 173-174 (2011).

[23] Following the 2005 departure of AIG's long-time CEO, Hank Greenberg, its board adopted governance and risk management changes seen as "best practices" as recommended by a former SEC Chairman. These proved ineffective, however, precipitating rather than preventing the company's 2008 insolvency after a small AIG unit wrote large volumes of unhedged credit default swaps. While commentators disagree on the strengths and weaknesses of AIG's pre-existing culture, they concur that imposing "best practices" without considering that context fostered AIG's collapse, which fueled the 2008 financial crisis. *Compare* Roddy Boyd, *Fatal Risk: A Cautionary Tale of AIG's Suicide* (2011) (arguing that the governance and risk management changes failed to address the pre-existing culture's *weaknesses*), *with* Maurice R. Greenberg & Lawrence A. Cunningham, *The AIG Story* (2013) (arguing that such changes failed to appreciate the pre-existing culture's *strengths*).

[24] We assume the FDIC agrees that the APA applies to the Proposal as it does not appear to fit any of the exceptions to the APA (*e.g*., interpretations, a general statement of policy, or rules of agency organization).

[25] We note a recent opinion in pending rulemaking of the SEC finding that the agency violated the APA by failing to substantiate a proposed rulemaking's putative benefits. *See Chamber of Commerce of the United States v. SEC*, 85 F.4th 760, 780 (5th Cir. Oct. 31, 2023). The court ordered the SEC to "correct the defects" within 30 days, to which the SEC responded that it was "not able" to do so. Letter from Ezekiel Hill, SEC Office of the General Counsel, to Clerk of Court, U.S. Court of Appeals for the Fifth Circuit 2 (Dec. 1, 2023), *Chamber of Commerce of the United States v. SEC,* ECF No. 145. It thus appears that the court will vacate the rule. We also note that the court faulted the SEC for failing to adequately respond to comment letters submitted on the Proposal as required by law.

As delineated throughout this letter, we are concerned that the Proposal and many of its provisions violate one or more of these requirements, including by (a) imposing prescriptive governance rules unrelated to safety and soundness and without any nexus to bank failures, (b) lacking supporting evidence of any benefits and insufficient evidence of costs, (c) imposing numerous untested governance and risk management ideas without a basis in principle or experience and applying them uniformly to a heterogenous group of banks, and (d) creating inconsistencies with existing federal banking law, state corporation law, and federal securities regulations. As a result, we respectfully suggest that the FDIC and its staff undertake a review of the Proposal under the APA's requirements and grounds for objection.[26]

9. Supreme Court Jurisprudence. The FDIC is issuing the proposed guidelines pursuant to Section 39 of the Federal Deposit Insurance Act, which contemplates safety and soundness standards.[27] It is far from clear how the proposed governance and risk management provisions relate to safety and soundness and whether the Proposal is otherwise a proper exercise of agency authority. The Proposal may therefore run afoul of longstanding jurisprudence concerning federal banking regulations.

For instance, the Supreme Court admonished the FDIC and other federal banking authorities in *Atherton v. FDIC* that agencies must act "pursuant to congressionally delegated authority" when prescribing governance standards for banks.[28] In the wake of *Atherton*, the banking sector primarily looked to state corporate governance law, although there remained instances of federal supplementation.

Moreover, the Supreme Court has recently held in several prominent rulings that assertions of executive branch authority on questions of major "economic and political significance" require clear congressional authority.[29] While Congress has clearly authorized federal banking agencies to supervise banks and promulgate related standards related to safety and soundness, there has been no clear and specific congressional authorization that would support the expansive governance mandates in the Proposal.

10. Alternative Course. If the FDIC wishes to pursue the topics contained in the Proposal further, we suggest that it consider an interagency release, working with the OCC and Federal Reserve. The FDIC would also do well to consider other proven approaches to these topics, such as the Federal Reserve's principle-based approach to bank corporate governance[30] and the interagency guidelines on bank safety and soundness.[31]

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[26] 5 U.S.C. §706(1).

[27] 12 U.S.C. §1831p-1.

[28] *Atherton v. FDIC*, 519 U.S. 213, 225 (1997)*; see also O'Melveny & Myers v. FDIC*, 512 U.S. 79, 88-89 (1994).

[29] *Biden v. Nebraska*, 143 S. Ct. 2355, 2373 (2023) (student loan forgiveness); *West Virginia v. EPA*, 142 S. Ct. 2587, 2608 (2022) (carbon dioxide emissions); *Nat'l Fed. of Indep. Bus. v. OSHA*, 595 U.S. 109, 117-118 (2022) (COVID vaccine mandate).

[30] Board of Governors of the Federal Reserve System, *SR 21-3 CA 21-1: Supervisory Guidance on Board of Directors' Effectiveness* (Feb. 26, 2021)

[31] 12 C.F.R. Pt. 364, Appendix A.

Specific Problems

1. Ignoring the Variety of Corporate Governance Models. The Proposal contemplates that boards "should consider the interests of all . . . stakeholders, including shareholders, depositors, creditors, customers, regulators, and the public." 88 Fed. Reg. at 70404. The FDIC should recognize that such a statement reflects one version of many competing models of corporate governance and that the many states where the various banks are organized adopt different versions. To illustrate:

- most states *require* directors to act in the best interests of their corporation and its shareholders;[32]
- many states *permit* directors to consider the interests of certain other constituencies (such as communities where a company's assets are located) at least under certain conditions, where such considerations are deemed in the best interests of the corporation;[33]
- at least one state *requires* directors to consider certain non-shareholder interests in some circumstances (such as employees in connection with changes in control);[34]
- some states *require* directors to prioritize the interests of creditors over shareholders when a corporation is insolvent;[35] and
- several states permit corporate charter documents to allow or require directors to consider the interests of designated non-shareholder interests.[36]

We also note that, under any model of corporate governance, the FDIC's list of "stakeholders" is anomalous in several respects. For one, it fails to list the financial institution itself as a beneficiary of director duties, even though directors and officers are obligated to act in the best interests of the insured depository institution. In addition, it deviates from the constituents commonly delineated in state corporate law statutes by listing "regulators" and "the public" as

[32] *E.g.*, Cal. Corp. Code § 309(a) (directors must perform their duties "in a manner such director believes to be in the best interests of the corporation and its shareholders . . ."); *Revlon, Inc. v. MacAndrews & Forbes Holdings, Inc*., 506 A.2d 173, 179 (Del. 1986) ("directors owe fiduciary duties of care and loyalty to the corporation and its shareholders"); *eBay Domestic Holdings, Inc. v. Newmark*, 16 A.3d 1, 25-26 (Del. Ch. 2010) (same).

[33] *E.g.*, Am Bar Ass'n, Mod. Bus. Corp. Act § 8.30(b); Conn. Gen. Stat. § 33-756(d) (permitting but not requiring such considerations); Ind. Code § 23-1-35-1(d) (directors "may, in considering the best interests of the corporation, consider the effects of any action on shareholders; employees; suppliers and customers" and "communities" where company assets are located); Mass. Gen. Laws ch. 156D, § 8.30(a)(3) (similar and requiring good faith belief that such considerations are in the best interests of the corporation).

[34] *E.g.,* 15 Pa. Stat. and Cons. Stat. § 1715(a) (requires directors to consider the effects of any action on the corporation's shareholders, employees, suppliers, customers, and creditors, and the communities in which the corporation operates"—including in resisting takeover).

[35] 8 Del. Code Ann. § 281; *North American Catholic Educational Programming Foundation, Inc. v. Gheewalla*, 930 A.2d 92, 94 (Del. 2007).

[36] *E.g.*, Cal. Corp. Code § 204(a)(10); Mass. Gen. Laws ch. 156D, § 8.30(a)(3); Tex. Bus. Org. Code § 21.401(e). Such an approach reflects a conception of the corporation as organized primarily for the benefit of shareholders while allowing shareholders, the only constituency entitled to vote to amend the charter, to elect to permit or require the board to consider other constituencies.

stakeholders, while failing to list "employees," "suppliers," and "communities" where an institution owns assets. 88 Fed. Reg. at 70391-92.

In short, the FDIC should appreciate that this provision would not harmonize easily or well with the variety of applicable state laws and would conflict with some in at least some circumstances. One solution would be to state that directors should perform their duties in accordance with applicable law and consider such interests as are required or permitted under that law, including the interests of the financial institution, its shareholders, depositors, creditors, customers, employees, suppliers, and communities where it owns assets.

2. Omitting Applicable Laws and Obligations. The Proposal states that "directors are governed by federal and state banking, securities, and antitrust statutes and by common law . . . ." 88 Fed. Reg. at 70404. This list omits two of the most important applicable governance authorities: (a) the corporate law of the state of incorporation, invariably a combination of statutory and judicial law, and (b) the stock exchange listing requirements for companies that have exchange-listed shares. We suggest inserting such references.

3. Arbitrary Impositions Concerning Board Skills. The Proposal is critical of boards that may have directors with overlapping or duplicative skills, knowledge, or experience. We appreciate the importance of a board possessing an optimal combination of skills to be effective overseers, but this should fall to the board's discretion rather than being dictated by regulators. For one, it is misguided to believe that eliminating all duplication is ideal. An effective board may often have multiple experienced members with shared backgrounds (in such areas as finance and strategy), whose interaction produces better information and decisions; [37] a suboptimal board may often have individual experts in specific fields (such as cybersecurity or anti-money laundering) who come to control decisions in those fields without the value of interaction.[38]

Moreover, each institution's context is unique and varies according to the personalities, circumstances, and cultures involved. Boards use self-assessments to identify skills gaps and areas where additional expertise would benefit the enterprise while recruiting new directors. Boards self-regulate for such matters and adopt procedures such as age limits or term limits or practices such as committee or chair protocols and self-assessments to guide directors to act in the best interests of the institution. It seems arbitrary and unwise for regulatory authorities to preempt or disrupt these practices and prerogatives by imposing blanket approaches or directives invariant to context.

4. Arbitrary Assumptions About Director Qualifications. While value may be attributed to board independence or diversity based on "demographic representation, opinion, experience, and ownership level," as the Proposal suggests (88 Fed. Reg. at 70395), the Proposal overemphasizes their degree of importance. We agree with the two FDIC directors who dissented from the Proposal and opined that industry knowledge and experience are more determinative of effective board oversight of banking safety and soundness. Although some states and stock exchange rules have called for disclosure of board diversity and many call for a high degree of director independence, Congress has not authorized the FDIC to prescribe such practices.

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[37] *See* Jeffrey L. Coles, *et al., Boards: Does One Size Fit All*?, 87 J. Fin. Econ. 329, 333, 344-45 (2008) (finding that companies with greater governance problems tend to have more diverse boards).

[38] *See* The Conference Board, *Taking a Long-Term Approach to Board Composition* 2-4 (2023), https://www.conference-board.org/pdfdownload.cfm?masterProductID=49086 (noting decline in disclosed business strategy expertise among directors in favor of less critical but trendy skills and expertise).

The Proposal directs boards to have "a majority of outside and independent directors," disqualifying those affiliated with a parent entity. 88 Fed. Reg. at 70405. This may prove shortsighted. Indeed, as noted, entirely overlapping board memberships are typical among banking institutions and do not run afoul of independence rules established by the OCC, Federal Reserve, SEC, and stock exchanges. As such, many affected financial institutions have identical boards of directors for the bank as for its holding company. Accordingly, we suggest deleting these requirements.

5. Unrealistic Expectations of Boards on Corporate Culture and Work Environments. The board is to "establish a corporate culture and work environment that promotes responsible, ethical behavior." 88 Fed. Reg. at 70405. This is another of many examples in the Proposal misconstruing the roles and capabilities of boards of directors as compared to management. While boards of directors often perform the function of setting a "tone at the top," it is a reach to expect them to be able to "establish cultures or work environments." These are managerial functions and responsibilities (in the case of work environments, these functions occur deep into the organization, such as in bank branches). We suggest qualifying this standard to something such as directing or overseeing management's efforts to promote cultures of compliance and related work environments.[39]

6. Unrealistic Expectations and Fallacious Assumptions about Boards Establishing Operating Policies. The Proposal says that "The board is responsible for establishing . . . the policies that . . . guide the operations of the covered institution . . ." 88 Fed. Reg. at 70405. This is another example of the Proposal misconstruing the roles and capabilities of boards of directors from management. Operations are the province of management, not boards, and boards should direct management to establish appropriate operational policies. Were this rule to be adopted, operational policy formulation—starting with a wholesale review of all existing policies—would utterly consume the time boards can devote to oversight. We suggest deleting.

The next sentence states: "These policies ensure that the board has a fundamental understanding of the business of banking . . .." 88 Fed. Reg. at 70405. This is fallacious; a board cannot learn about the business of banking by drafting its operating policy, and only someone who understands the business can draft a suitable operating policy. We suggest deleting this proposal.

7. Unrealistic Expectations of Boards to Write Code of Ethics. The Proposal refers to an institution-wide code of ethics to be "written and adopted by the board" and later says the "board should establish a written code of ethics for the covered institution, covering directors, management, and employees." 88 Fed. Reg. at 70395, 70405. This is another example of the Proposal misconstruing and conflating functions of boards and management. Boards can and do direct management to develop institution-wide codes of ethics for the board's review and approval, and both federal securities laws and stock exchange listing rules require companies to adopt codes of ethics.[40] But the development of such codes, particularly those applicable to employees, is a

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[39] If corporate management fails to establish an appropriate culture or work environment, it is within a board's purview to replace that management.

[40] *See* Sarbanes-Oxley Act of 2002, Pub. L. 107-204, §406, 116 Stat. 745, 789-90, codified at 15 U.S.C. § 7264; New York Stock Exchange, *New York Stock Exchange Listed Company Manual* §303A.10, Code of Business Conduct and Ethics.

management function. Institution-wide promulgation of the code must originate with management and be developed with internal input. We suggest deleting or modifying accordingly.

8. Unrealistic Expectations of Boards on Controls. Section III of the Proposal contains a series of provisions prescribing the production of various programs and controls, in most cases directing management to establish and implement them and the board to oversee and approve them. Such an allocation of responsibilities between the board and management is appropriate and reflects both applicable law and standard governance practice.

But Section III also contains numerous misguided examples. In at least three instances, the Proposal directs the board to establish certain programs and processes that are the responsibility and prerogative of management, not boards: 1. the risk management function (III.A); 2. handling risk limit breaches (III.E); and 3. dealing with violations of law (III.F). We suggest conforming this provision to the similar provisions requiring management to establish matters.

9. Arbitrary and Intrusive Committee Prescriptions. The Proposal prescribes four board committees: audit, compensation, risk, and trust (when in the trust business). But such a prescription fails to appreciate how optimal committee design varies by institution.

After all, board structure is shaped by the exchange listing standards and securities laws for those institutions subject to them, as well as by the Federal Reserve for bank holding companies and the OCC for national banks. Moreover, the prescription fails to reflect the prevalence of nominating and governance committees on many boards. Finally, while all 57 affected banks appear to have similar committee structures, there is variation, and the FDIC should support variation because tailored provisions, rather than one-type-fits-all rules, promote effective corporate governance.

In addition, the Proposal lists specific "other" committees that banks may wish to adopt. By including them in the Proposal, institutions may feel pressured to adopt such additional committees even if they are not needed. When combined with the Proposal's expectation that boards "ensure" certain outcomes, institutions may fear that failure to adopt such additional committees may be held against them should the FDIC's expected, often unrealistic, outcomes not come to fruition.

10. Questionable Value in Requiring Mission Statements. The Proposal says that boards are to "direct the CEO to develop a written strategic plan," which must look out at least three years. 88 Fed. Reg. at 70405. We note that this approach appropriately reflects the role of the board to oversee and the role of management to develop strategy under the CEO's leadership. We also appreciate that some other banking authorities may likewise require strategic plans, and may even prescribe definitive time horizons, such as three years. But also worth appreciating is that such plans may or may not promote institutional safety or soundness.

Moreover, the Proposal prescribes that each strategic plan shall include a mission statement. We believe this is an issue of form over substance that deserves more careful consideration. For one, there is a great diversity of opinion about the utility and appropriate scope of institutional mission statements. Some business leaders support mission statements as guides to behavior. But many worry that they impede healthy cultural evolution. Still others note that words unsupported by reinforced practices may make mission statements ring hollow. It may be recalled that Enron had a mission statement boasting the loftiest values, including respect for others, and

integrity comprised of being open, honest, and sincere.[41] We suggest deleting or at minimum conducting more research on the correlation between mission statements and whatever problem the FDIC is seeking to address by this element of the Proposal.

11. Problematic Compliance Mandate on Boards. The Proposal suggests each director must "oversee and confirm . . . compliance with all laws and regulations." 88 Fed. Reg. at 70404. We believe that this provision is infeasible, unrealistic, and contrary to law and settled corporate governance practice. For one, we are unaware of any law requiring any organization's directors to report all violations of law to relevant authorities, even after the bank consulted legal counsel (*see, e.g.,* 88 Fed. Reg. at 70409 n.50). More importantly, we are concerned that this Proposal conflicts with the reporting on violations of designated laws under federal banking law[42] and contrasts with the limited scope of reporting obligations under many state banking laws.[43]

Moreover, the strongest version of any legal compliance duty for directors is that developed by Delaware courts under the *Caremark* line of cases "to attempt in good faith to assure that a corporate information and reporting system, which the board concludes is adequate, exists."[44] Further, the provision poses concerning implications for the attorney-client and other privileges. We suggest that the provision be deleted.

12. Abrupt and Arbitrary Timing. It appears that the Proposal would be binding immediately upon adoption to banks currently within its scope and would likewise instantly become applicable to any banks as soon as they are in scope, giving banks no compliance transition period. This arbitrary scope trigger is onerous and very expensive—not to mention unnecessary, as no benefits accrue from such a trigger compared to a graduated transitional approach. Moreover, it is dangerous. We caution again that hasty imposition of uniform governance standards on a functioning institution poses grave risks of unintended consequences—namely, causing or fostering the very failures sought to be prevented.

The expectations set forth in the Proposal will also be extremely time-consuming to try to meet. Realistically, if as the Proposal contemplates, a board is expected to approve the many management-level policies covered by the Proposal; draft certain other policies; revise their structures to comply with arbitrary and contradictory independence expectations; build out the entire institution's culture; and "ensure" the outcomes set forth by the Proposal -- then including a meaningful on-ramp is a must. If the FDIC proceeds with a scaled-back Proposal that reflects our input, we suggest creating a transition period of up to 24 months for banks to come into compliance.

[41] Enron Annual Report (2000), https://enroncorp.com/corp/investors/annuals/2000/ourvalues.

[42] *E.g.*, 12 U.S.C. § 1831m(b)(2) ("Each insured depository institution shall prepare . . . (2) a report signed by the chief executive officer and the chief accounting or financial officer of the institution which contains (A) a statement of the management's responsibilities for . . . (iii) complying with the laws and regulations relating to safety and soundness which are designated by the Corporation and the appropriate Federal banking agency . . .").

[43] *E.g.*, N.Y. Comp. Codes R. & Regs. tit. 3 §§ 300.1 & 300.7 (mandating reporting of designated events to banking superintendent and urging reporting of others to law enforcement authorities).

[44] *In re Caremark Int'l Inc. Deriv. Litig.*, 698 A.2d 959 (Del. Ch. 1996).

Conclusion

Finally, we comment briefly on three of the questions the FDIC posed in its notice of this rulemaking.

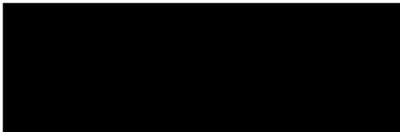
1. The notice asks if the Proposal should include more specific suggestions for corporate governance or more specific requirements for risk management. We believe the Proposal contains too many such suggestions, is overly prescriptive, and should be revised accordingly.

2. The notice asks if the Proposal provides sufficient and appropriate requirements regarding the role of a board for corporate governance and risk management and the role of executive management for managing the covered institution and its risks. We believe that the Proposal often inadvisably blurs the responsibilities and distinctions between boards and management, and should be revised to respect the proper boundaries.

3. The FDIC asks: "Would the [Proposal] have any costs or benefits that the FDIC has not identified?" 88 Fed. Reg. at 70399. The Proposal would create many and substantial costs the FDIC has not identified, including those detailed above that would impose significant costs on all affected institutions, as well as threaten the profitability and solvency of quite a few without providing corresponding benefits.

We would be happy to discuss these points further and offer other assistance to the FDIC to assure that any guidelines it adopts would promote effective governance and risk management and avoid the serious consequences that the Proposal risks.

Sincerely,



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