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By email: Comments@FDIC.gov, RIN 3064-AF94

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

Dear Mr. Sheesley:

Discover Bank (Bank) appreciates the opportunity to comment on the Federal Deposit Insurance Corporation's (FDIC's) notice of proposed rulemaking on Guidelines Establishing Standards for Corporate Governance and Risk Management for Covered Institutions with Total Consolidated Assets of $10 Billion or More (Proposal). The Bank is a Delaware state non-member insured depository institution and wholly owned subsidiary of Discover Financial Services (DFS), a bank holding company regulated by the Federal Reserve Board (FRB) (the Bank and DFS hereinafter collectively referred to as Discover). Discover supports the FDIC in this important effort to provide thoughtful guidance on the expectations of boards and their duties to oversee the bank and is committed to full board engagement to protect the safety and soundness of the insured depository institution. Because of the importance of boards in contributing to safety and soundness, it is crucial that banks are able to attract and retain qualified and dedicated directors. Blurring the lines between management and directors will make this more difficult. We believe that clearly distinguishing the roles of management and the board of directors allows directors to set and focus on broad policy and a culture of safe and sound operations, while providing careful attention to especially important issues, and allows management to act effectively and expeditiously to address risks. To support such efficiency in roles, we urge the FDIC not to require board review and approval of all policies, particularly in the case of the larger banks that would be subject to the Proposal.

Discover is particularly concerned that the Proposal would impose novel restrictions on the ability of an independent director to serve on both a bank's and its holding company's board and the impact that may have on achieving enterprise-wide oversight of the company's business operations and risks. We share the FDIC's position that matters at the level of the bank merit focused board attention. In addition to the efficiency of having members who are both bank and holding company directors, overlapping membership also ensures that bank level issues are considered in the broader context and that those issues have informed champions at the parent board. We address these points in more detail in this letter.

I. Discover Shares the Concerns Expressed in Many of the Other Comment Letters

Discover shares the concerns expressed in many of the trade and professional comment letters submitted, including those submitted by the Bank Policy Institute (BPI) together with the American Association of Bank Directors, the American Bankers Association (ABA), the Society for Corporate Governance (Society), National Association of Corporate Directors, Mid-Size Bank Coalition of America, and Chamber of Commerce. We will not burden the FDIC's reviewers by reiterating those concerns in this letter; we refer the FDIC instead to the extensive points made in these other comment letters. Notably, we

agree with these comment letters that the Proposal blurs the separation of roles and responsibilities recognized under existing corporate law standards for boards of directors versus management and, in doing so, imposes new duties on the board that could impair the ability of the directors to focus on core business and risk issues intended to protect the institution's safety and soundness.

Further, we do not view the Proposal as being merely a compilation of existing FDIC guidance. In addition to conflicting with existing state statutory and general corporate law standards,[1] the Proposal is far more prescriptive than the Office of the Comptroller of the Currency's (OCC's) Heightened Standards for Large Institutions[2] and the FRB's Supervisory Guidance on Board of Directors' Effectiveness.[3] Core governance standards like those in the Proposal should be more consistent across all chartered institutions to ensure that there are no conflicting expectations among the multiple regulators overseeing an enterprise made up of multiple entities. It is an important policy objective that insured depository institutions be subject to comparable standards, whether their primary federal regulator is the FDIC, the OCC, or the FRB.

Generally speaking, the role of the board is to oversee the conduct of the institution's business and hold management accountable; the role of management is to implement business initiatives and manage day-to-day business operations and their related risks.[4] We are concerned that the Proposal moves away from these well-established roles and instead proposes many new operational and compliance obligations on the board itself, such as having the board review and approve *all* policies (voluminous even for smaller institutions), which will undermine the board's ability to engage in its critical duties to oversee management and hold management accountable. Counter to the Proposal's requirements, it is well-established practice that the board should not be itself "establishing" different programs, policies, and plans governing bank operations; rather, it should direct management to do so, subject to the board's oversight.[5] The board is not responsible for "ensuring" implementation results, but it must hold management accountable for successful implementation.

It is important that the board's time be spent on oversight of key risk and business issues, and not on such things as standard policy reviews. Outside bank directors are chosen for their experience and knowledge in financial services, information technology, risk management and other business areas to oversee management's business and risk decisions. While some key bank policies must be reviewed and approved by the board as required by applicable statutes (e.g., Bank Secrecy program documents) or due to the bank's risk profile, the very voluminous bulk of routine policies necessary for bank operations do not. It is important that available director time and attention be reserved for oversight of the most critical bank matters, ones that could expose the bank to the highest levels of risk.

The Proposal further contains other new obligations, such as requiring the board to "confirm" the safe, sound and compliant operations of the bank, which is outside the role of the board as recognized under prevailing corporate governance standards.[6] It also imposes more personal liability on directors, which is likely to result in a decrease in the available pool of those qualified individuals willing to serve on bank

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[1] For example, contrary to most state corporate laws directing that the board act in the best interests of the company and its shareholders, it is proposed that the board consider the interests of a wide range of stakeholders.
[2] 12 CFR Part 30, Appendix D.
[3] Federal Reserve Board SR 21-3 (February 26, 2021).
[4] *See, e.g.*, FDIC Pocket Guide for Directors, https://www.fdic.gov/resources/bankers/bank-directors/pocket-guide/index.html.
[5] Group of Thirty, Toward Effective Governance of Financial Institutions (2012) at 19-20. "Well-functioning boards scrupulously . . . [R]espect the distinction between the board's responsibilities for direction setting, oversight, and control, and management's responsibilities to run the business. It is misguided and dangerous to conflate the responsibilities of management with those of the board."
[6] For an authoritative discussion of the distinct roles of the board versus management, see The National Association of Corporate Directors, The Role of the Board v. The Role of Management (Feb.2022) (primer on fundamentals).

boards.[7] Given the challenge that banks already face in attracting new qualified directors, any additional exposure making a bank director role less attractive than board roles at non-financial entities and smaller institutions not covered by the Proposal will present serious director recruitment challenges for financial institutions.

In general, the inconsistencies of the Proposal with existing governance standards emanating from state law may cause significant issues for state banks attempting to comply with the state banking laws under which they are chartered and applicable state corporate laws, in addition to the listing exchange and other self-regulatory requirements to which they may be subject.[8] The Proposal may have unintended consequences that may result in undermining the attractiveness of the state bank charter.

The Proposal also would impose limitations on a bank's ability to share a common risk governance framework with its parent if its risk profile is deemed not "substantially similar,"[9] a term which is vague and should be clarified. A requirement to maintain separate governance and risk management practices at the bank versus the holding company may mean for many institutions that the existing frameworks they have developed to enhance enterprise-level risk controls, based on regulatory expectations, may need to be unnecessarily redesigned, which could be costly and may actually weaken the overall risk management framework of the institution. Boards need sufficient flexibility to harmonize bank-level and bank holding company-level risk management controls in a manner that is most effective and efficient, taking into account the institution's size, business model, complexity, and risk profile.

II. Issues of Particular Concern to Discover

As noted above, Discover agrees with many of the concerns raised in the other filed comment letters, there are several issues raised by the Proposal that are of particular concern to Discover, including the new independence standard proposed for directors, among other new proposals regarding board composition.

The Proposal sets forth novel requirements for determining the "independence" of directors that is inconsistent with the definitions under existing banking and corporate laws and governance standards.[10] The Proposal's standard conflicts with independence standards adopted by the OCC, the FRB, Securities and Exchange Commission (SEC), and the listing exchanges. It is not uncommon for a bank and bank holding company board to have the same or overlapping independent directors. But implementation of

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[7] The American Association of Bank Directors (AABD) has conducted surveys finding that 24.5% of bank respondents faced bank directors resigning or stepping down from certain board committees citing fear of personal liability and candidates refusing director offers because of fear of personal liability. AABD Survey Results on Measuring Bank Director Fear of Personal Liability are Not Good News, April 9, 2014, AABD.

[8] For example, the Proposal would require that boards consider the interests of a range of stakeholders, instead of the acting in the best interests of their companies and shareholders as required, for example, under Cal. Corp. Code Section 309(a) (directors must perform their duties "in a manner such directors believe to be in the best interests of the corporation and its shareholders").

[9] The Proposal provides that if an institution has a parent company and the risk profiles of each entity are substantially similar, the institution may adopt and implement all or any part of its parent's risk management program that: (i) satisfies the minimum standards in the Proposal; (ii) ensures that the safety and soundness of the institution is not jeopardized by decisions made by the parent company's board and management; and (iii) ensures that the institution's risk profile is easily distinguished and separate from that of its parent for risk management and supervisory reporting purposes. The Proposal goes on to state that consideration of these factors may require the institution to have separate and focused governance and risk management practices. 88 F.R. 70407.

[10] The Proposal would define an independent director as one that is (a) not a principal, member, officer, or employee of the institution, and (b) not a principal, member, officer, or employee of any affiliate or principal shareholder of the institution. 88 F.R. 70405. It requires independence from the affiliate, where other existing standards require independence from management. *See, e.g.*, the FDIC's own regulations, 12 CFR Section 363.5 (providing that a majority of members of audit committees should be "independent of management of the institution.")

the proposed new independent[11] director standard, where a bank director cannot serve on the holding company board and still be viewed as independent unless certain circumstances are met, and vice versa, may mean that banks and their holding companies would likely need to obtain a new slate of independent directors for their boards. Footnote 45 of the Proposal requires clarification, but it would appear to allow a holding company director to also serve on the bank board only if the holding company conducts "limited or no additional business operations"[12] outside of operating the bank.

It is unclear what the scope of "limited" business operations may be and this should be clarified, but in any case, banking institutions have historically been able to have common members among the bank and holding company boards. "Independence" has been defined under corporate and securities law requirements as independence from management, i.e., the director having no material personal, financial, or other ties to the bank and the holding company, related transactions, and holdings. For example, under the New York Stock Exchange and other exchange rules, independence means that directors cannot hold management positions at the company, its parents and subsidiaries; where the director candidate formerly had been a company employee, the individual must have departed three years or more ago from the company, among other "bright line" criteria.[13] Under the bright line criteria, directors are determined to lack independence because certain facts demonstrate that through personal or other relationships the director is beholden to the controlling party. Without such a showing, independence should not be interpreted as requiring separate membership at the bank and the holding company boards.

It is also unclear why the proposed independent standard is necessitated by, or for that matter facilitates, safety and soundness. This standard has been proposed and rejected in the past for regulated entities. For example, in 2014, the Financial Stability Oversight Council (FSOC) proposed an order for enhanced prudential standards for certain designated nonbank financial companies that would have imposed a similar independence standard.[14] The comment letters filed in response explain how the proposed independent director standard can diminish a board's effectiveness.[15]

Persuasive arguments made against the proposed independent standard include that directors are already personally liable to fulfill their fiduciary duties to their company's shareholders, subject to well-established duties of loyalty and care, in addition to regulatory oversight. Directors are accountable to their shareholders, including if their shareholder is the parent holding company. It has been argued that as a legal matter, there is no conflict that gives rise to a so-called "dual fiduciary problem" because the director duties are aligned—the common director has the same duty of good management to both corporations to be exercised in the light of what is best for both corporations.[16]

[11] A similar independence standard for directors was discussed in the comment letters cited in footnote 18 below and filed on behalf of GECC in response to the FSOC's 2014 designation and has been discussed in other comment letters critiquing the proposed new independence standard.
[12] 88 F.R.70405, fn. 45.
[13] *See* New York Stock Exchange, New York Stock Exchange Listed Company Manual, Section 303A.02 Independence Tests (2013). Even if a director meets all the bright line criteria set out in Section 303A.02(b), the board is still required under Section 303A.02(a) to consider relevant facts and circumstances and to make an affirmative determination that the director has no material relationship with the listed company.
[14] *See, e.g.*, the comment letters in response to FSOC's proposal filed on behalf of General Electric Capital Corporation (GECC) in connection with its designation which included submissions from Sidley Austin LLP written by Jack B. Jacobs (Jacobs letter); a letter submitted by the Society of Corporate Secretaries & Governance Professionals written by Darla C. Stuckey (Stuckey letter); a submission from Wilson, Sonsini, Goodrich & Rosati written by Chancellor William B. Chandler III (Chandler letter); and a letter written by the sixteen independent directors of General Electric Company (GE letter). Docket No. R-1503, Application of Enhanced Prudential Standards and Reporting Requirements to General Electric Capital Corporation, 79 Fed. Reg. 71,768 (Dec. 3, 2014).
[15] The comment letter arguments were successful; the final order did not require separate independent director membership at the bank and holding company levels. 80 FR 44111 (June 25, 2015), at 44117.
[16] *See, e.g.*, Chandler letter at page 7, Docket No. R-1503, id at fn. 14.

Further, the proposed independent standard compounds the difficulty for corporations to persuade qualified individuals to serve as directors, as well as the ability of the directors on the separate, but related, boards to efficiently fulfill their duties.[17] Separate membership on the bank versus the holding company boards does not seem necessary because the bank directors owe fiduciary duties to the parent shareholder, and conversely, the holding company directors have fiduciary duties to protect the interests of the insured bank. Separate membership is also less efficient because to achieve transparency and accountability, more processes are needed for the bank board to report to the holding company. Separate boards make it more costly and cumbersome by requiring separate meetings with separate agendas, materials, minutes, and secretaries. In the end, the proposed requirement is counter to the goal of enterprise-wide success and stability over the long term.

Importantly, common membership on the bank and holding company boards facilitates enterprise-wide understanding of the whole company's operations and risks. The proposed independent director standard could actually undermine the directors' independent oversight of the company's enterprise risk by "disrupting the cohesive decision-making that is necessary for the effective governance of a complex wholly-owned subsidiary."[18] Although there may be organizations where separate boards work adequately, in essence, a holding company and subsidiary bank board would inevitably be working, at least to some extent, in separate spheres.

In any event, the decision to appoint common members should be based on the institution's board and senior management determination of the best composition given the institution's size, complexity, risk profile, and business model. Many institutions historically have determined that common boards, by eliminating duplication of functions and generating synergies for board oversight, offer the most effective composition for their business and risk management oversight purposes. Congruent board membership structure leads to more efficient use of the boards' time and more effective director engagement. It could be costly, disruptive, and run counter to effective oversight objectives if a company was required to dismantle its overlapping board membership structure.

The Proposal also appears critical of boards where multiple directors have overlapping or duplicative skills, knowledge, or expertise.[19] It is important that a board have directors with a balance of skills and diversity in professional backgrounds and expertise, including expertise that may be common among directors and will allow the directors to effectively interact and challenge each other's viewpoints. The strength of the board is diminished when directors are appointed as the sole experts in given areas (cybersecurity, consumer lending, technology, etc.), which can balkanize a board and lead to some directors becoming reliant on the recognized expert in a given area rather than each director fully engaging on all matters before the board and each director being able to exert a credible challenge to any matter coming before the board. It also makes it more difficult to follow the corporate governance best practice of periodically rotating directors' committee assignments if many directors' expertise is so narrow that they are unqualified to serve on different committees. An institution should be able to conduct its own evaluation, including through the board's self-assessment process, of the strength and diversity of its directors' expertise and determine whether to enhance areas or fill gaps as appropriate, add new members or establish additional committees as the board believes will be most effective.

[17] *See, e.g.*, the Stuckey letter at page 2, Docket No. R-1503, id at fn. 14.
[18] GE letter at page 1, Docket No. R-1503, id at fn. 14.
[19] "A board that includes multiple members with similar experiences. . . may result in a lack of creativity or individual responsibility for decisions, or gaps in knowledge, experience, or oversight, increasing risk to the institution." 88 F.R. 70395.

III. Summary

In closing, we share the FDIC's commitment to the importance of board engagement but believe flexibility is necessary to allow an institution to assess how best to structure board oversight in light of an institution's size, business model, complexity and risk profile, taking into account an appropriate governance and risk management framework; the right degree of common controls and practices between the bank and bank holding company; the necessary expertise and qualifications of its directors; and the mix of independent versus inside directors, among other key governance features. Accordingly, to avoid disadvantaging state non-member banks and resulting in other unintended consequences, we request that the FDIC consider reevaluating its Proposal and adopting standards more consistent with those promulgated by the OCC and the FRB, with the goal of proposing corporate governance practices that work effectively and efficiently for a wide variety of business models and organizational sizes, complexity, and risk profiles.

Discover values the opportunity to comment on the Proposal and appreciates your consideration of the views expressed in this letter. We would be happy to provide more information about our comments and the important concerns we see raised by the Proposal.

Sincerely,

Hope D. Mehlman
Executive Vice President, Chief Legal Officer, General Counsel, and Corporate Secretary