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February 9, 2024

Mr. James P. Sheesley
Assistant Executive Secretary
Federal Deposit Insurance Corporation
550 17th Street NW
Washington, DC 20429
Sent via email comments@fdic.gov

Re: *Guidelines Establishing Standards for Corporate Governance and Risk Management for Covered Institutions with Total Consolidated Assets of $10 Billion or More (RIN 3064-AF94)*

Dear Mr. Sheesley:

The National Association of Industrial Bankers ("NAIB") appreciates the opportunity to provide comments to the Federal Deposit Insurance Corporation (FDIC) on its proposed Guidelines Establishing Standards for Corporate Governance and Risk Management for Covered Institutions with Total Consolidated Assets of $10 Billion or More (Proposed Guidelines). In the Proposed Guidelines, FDIC shares that it believes additional, widely applicable FDIC heightened corporate governance standards are necessary to help it better avoid large insured institution failures and risks to the Deposit Insurance Fund (DIF) and describes the Proposed Guidelines as a means to better align its existing standards with those of the Office of the Comptroller of the Currency (OCC) and the Federal Reserve Board (FRB).

NAIB is the national association for industrial banks (IBs). First chartered in 1910, industrial banks operate under several titles: industrial loan banks, industrial loan corporations, or thrift and loan companies. These banks engage in consumer and commercial lending on both a secured and unsecured basis. They do not offer demand checking accounts but accept time deposits, savings deposit money market accounts, and NOW accounts. Industrial banks provide a broad array of products and services to customers and small businesses nationwide, including in some of the most underserved segments of the U.S. economy. These same institutions are also commonly referred to as industrial loan companies (ILCs).

We believe a qualified, well-informed, and active board of directors (board) is vital to an insured institution's safety and soundness. However, before so dramatically reshaping prudently managed, already closely supervised institutions' corporate governance, FDIC has a responsibility to clearly articulate why its continuous examination process (CEP) and other components of its existing regulatory framework are insufficient to help it better avoid large insured institution failures and related risks.

FDIC has not yet met that responsibility here, and we strongly urge FDIC to fully withdraw the Proposed Guidelines out of significant concern that the Proposed Guidelines would undermine – not strengthen – the safety and soundness of covered institutions.

If FDIC can better articulate why additional FDIC heightened corporate governance standards are reasonably necessary FDIC should propose principles-based standards in the form of guidance – not as highly prescriptive, enforceable guidelines. FDIC's principles-based heightened corporate governance standards guidance should align with established principles of prudent corporate governance, be aligned with OCC's and FRB's standards, be appropriately tailored to apply only to institutions that may truly present heightened safety and soundness concerns and be applied consistently across covered institutions.

Furthermore, FDIC should be expressly clear that, in issuing such standards, the FDIC does not intend to conflict with or supersede applicable state law.

Specific Concerns

I. Enforceable heightened standards are unnecessary and can produce harmful, illogical outcomes.

If additional FDIC heightened corporate governance standards are reasonably necessary, we strongly urge FDIC to adopt such standards as principles-based guidance – not as highly prescriptive, enforceable guidelines.

There are meaningful legal and operational differences between otherwise identical guidance and guidelines. And, as FRB has shown, a federal banking regulator can, without being overly prescriptive, successfully leverage guidance to address the same heightened corporate governance and risk management risks FDIC intends the Proposed Guidelines to address. Section 39 enforceability is wholly inappropriate where strict compliance is not only unnecessary but may be functionally impossible and may risk violation of other applicable laws, regulations, and fiduciary standards.

If additional FDIC heightened corporate governance standards are reasonably necessary, FDIC should, like OCC, be expressly clear that, in issuing such standards, it does not intend to conflict with or supersede applicable state law.

II. The proposed $10B "covered institution" asset threshold is too low.

In the Proposed Guidelines, FDIC references heightened standards for OCC-supervised institutions with average consolidated assets of $50 billion or more. FDIC also references heightened standards contained in the FRB's Regulation YY and various Supervision and Regulation Letters for bank holding companies with total consolidated assets of $50 billion or more. Yet, seemingly for no reason other than the Proposed Guidelines' covered institutions are already subject to its CEP, FDIC proposes to adopt a much lower $10 billion threshold.

As part of its CEP, FDIC has a well-established process for identifying more complex institutions and procedures for conducting more thorough examinations when necessary. That FDIC-supervised institutions with assets of $10 billion or more are already subject to FDIC's CEP is hardly justification for imposing on all those prudently managed, already closely supervised institutions additional, highly prescriptive heightened corporate governance standards. It is, in fact, all the more reason for FDIC to adopt an initial covered institution asset threshold consistent with OCC's and FRB's heightened standards for larger institutions with potentially more complex risk profiles.

We strongly encourage the FDIC to adopt an initial covered institution asset threshold of at least $50 billion and establish a procedure for its regular inflation-based adjustment.

III. Proposed Guidelines would fundamentally reshape covered institutions' corporate governance and carry significant but avoidable risks.

CORPORATE GOVERNANCE

General Obligations of the Board

The Proposed Guidelines would require directors, irrespective of applicable state shareholder or stakeholder fiduciary standards, to consider, "the interests of all its stakeholders, including shareholders, depositors, creditors, customers, regulators, and the public." Applicable state laws notwithstanding, directors deemed in violation of this proposed new standard would be subject to removal, criminal prosecution, civil money penalties, and civil liability.

We strongly urge FDIC to withdraw this proposed standard. Alternatively, we recommend that FDIC amend this proposed standard to clearly convey that a board may consider the interests of stakeholders to the extent permitted by applicable laws, regulations, and their institution's bylaws.

Board Composition – Diversity

The Proposed Guidelines provide that a covered institution's "board should consider how the selection of and diversity among board members collectively and individually may best promote effective, independent oversight of covered institution management and satisfy all legal requirements for outside and independent directors. Important aspects of diversity may include: social, racial, ethnic, gender, and age differences[.]" However well-intentioned, this proposed standard that a board consider existing and potential directors' race, ethnicity, gender, and age is wholly inappropriate and likely subject to legal challenge.

We strongly urge FDIC to withdraw the proposed standard and to be exceptionally careful and realistic in how it sets expectations of individual directors and how it describes those expectations.

Board Composition – Independent Director Majority

The proposed standard goes far beyond what OCC and FRB feel is necessary for their far larger and, in some cases, far more complex institutions and covered institutions are already subject to independent audit committee standards under Section 36 of the FDI Act and part 363 of FDIC's regulations.

Likely, the proposed standard and accompanying personal liability for directors will encourage many existing directors to withdraw from their institutions and also discourage many of the already too few qualified director candidates from accepting directorships.

The boards of many prudently run covered institutions are not majority independent today. And the proposed standard ignores the value of directors keenly attuned to a covered institution's history, community, and roadmap, and ignores the realities of our nation's director population and pipeline. To meet FDIC's proposed standard, covered institutions may be able to increase the number of directors on their boards and attract independent directors to fill those openings. However, many covered institutions simply lack the resources to successfully compete for the already too few available qualified independent director candidates. Those institutions unable to attract enough new independent directors to meet FDIC's proposed standard would be forced to shrink their boards and cut insider directors irrespective of those directors' value to their institution.

We strongly urge FDIC to fully withdraw this proposed standard.

Additionally, FDIC's proposed novel definition of an independent director – i.e. a director that is "not a principal, member, officer, or employee of the institution [or of] any affiliate or principal shareholder of the institution" – would prohibit directors serving on a bank holding company board from serving on a wholly-owned covered institution's board. Such a standard would be inconsistent with OCC and FRB standards and would upend prudently composed boards across broad swaths of the banking industry. Overlapping boards at the bank and holding company levels are not only time- and cost-efficient but better support enterprise-wide risk management and provide many institutions exceptional director talent perhaps otherwise unavailable to them.

Therefore, we strongly urge FDIC to fully withdraw this proposed definition. At a minimum, FDIC should clarify that serving on the board of a bank holding company would not disqualify an individual from being an independent director of a wholly owned covered institution.

Duties of the Board

Set an Appropriate Tone

Here and elsewhere the Proposed Guidelines risk, perhaps inadvertently, disturbing well-functioning divisions of responsibility among covered institutions' boards and management by using *establish* and similarly narrow verbs.

We encourage FDIC to withdraw this proposed standard. At a minimum, FDIC should replace *establish* with *foster*, *maintain*, or some similar word or phrase that recognizes that setting an appropriate tone at the top is the collective responsibility of a covered institution's board and management, not the board's alone.

Approve Strategic Plan for the Covered Institution.

FDIC proposes to require that, "[a]t least annually, the board should […] ensure the strategic plan is consistent with policies the board has approved." FDIC's proposed use of *ensure* risks creating significant uncertainty by establishing a standard with which strict compliance is either functionally impossible or so cumbersome as to be unrealistic. While both OCC and FRB have previously used *ensure* to describe board responsibilities, both agencies not only express their heightened standards in principles-based form but have also intentionally moved away from using *ensure* to describe board responsibilities over which directors do not have total, sole control – as is the case here.

We strongly urge FDIC to fully withdraw this proposed standard and all other proposed standards as part of which it uses *ensure* and similarly narrow verbs to describe board responsibilities over which directors do not have total, sole control.

Approve Policies

The Proposed Guidelines provide "[t]he board is responsible for establishing and approving the policies that govern and guide the operations of the covered institution in accordance with its risk profile and as required by law and regulation." A board simply cannot and should not be required to review and approve every operational policy. And there is simply no need for such a standard because a board's regular risk-based review of its institution's operational policies is already a core part of the board's effectively overseeing management.

We encourage FDIC to withdraw the proposed standard.

Establish a Code of Ethics

FDIC proposes to require that a "board should *establish* a written code of ethics for the covered institution, covering directors, management, and employees." A board may, as part of its broader oversight function, review some parts of a covered institution's framework to promote high ethical standards. But it is entirely inappropriate to task the board with *establishing* such a framework – clearly something best coordinated by executive management and carried out by management across a covered institution.

Furthermore, there is not a single path a covered institution may follow to promote high ethical standards. Covered institutions prudently promote high ethical standards through various combinations of policies and procedures. Because institutions can have separate policies and procedures – all of which individually and collectively promote high ethical standards, institutions can quickly respond to whatever ethical challenges they may face, no matter how novel.

We encourage FDIC to withdraw the proposed standard.

Provide Active Oversight of Management

The Proposed Guidelines provide that a "board should hold management accountable for adhering to the strategic plan and approved policies and procedures to *ensure* the covered institution's compliance with safe and sound banking practices and all applicable laws and regulations." The Proposed Guidelines also provide that a "board also must *ensure* that management corrects deficiencies that auditors or examiners identify in a timely manner." FDIC's uses of *ensure* in this section conflates a board's oversight functions and management's day-to-day operational functions and would deprive covered institutions of fundamental exam appellate rights.

Unless FDIC intends to require that a covered institution's board usurp management's day-to-day operational functions, it is unreasonable to expect that any board can effectively *ensure* a covered institution's compliance with safe and sound banking practices and all applicable laws and regulations. A board certainly must hold management accountable and has a responsibility to replace non-performing management. But a board cannot effectively ensure the performance of any specific executive.

FDIC's proposal to require covered institutions' boards to *ensure* that management corrects deficiencies that auditors or examiners *identify* goes a step further in the wrong direction. The Proposed Guidelines ignore that FDIC-examined institutions have a right to appeal identified audit or exam deficiencies. The Proposed Guidelines would effectively force directors to choose between replacing management who insist on appealing identified audit or exam deficiencies and exposing themselves to personal liability for failing to replace management, the most drastic oversight mechanism available to them.

Therefore, we strongly encourage FDIC to withdraw the proposed standard.

Exercise Independent Judgment

Unquestionably, every director must act consistent with his or her fiduciary duties by exercising independent judgment that he or she reasonably believes is prudent. The proposed standard, however, is wholly unnecessary. Applicable state fiduciary standards and existing FDIC regulations and guidance already accomplish what FDIC hopes to accomplish by establishing the proposed standard.

Every covered institution's directors are already subject to state fiduciary standards and FDIC regulations that establish and clearly articulate directors' responsibility to exercise independent judgment and provide effective challenge to management. These existing standards and regulations also already appropriately protect a boards' authority to seek information from not only a CEO but also other executives, managers, regulators, and relevant third parties and protect individual directors' opportunities to raise issues, express concerns, and otherwise be fairly heard.

The proposed standard would define a *dominant policymaker* as "management, a director, a shareholder, or any combination thereof". Under such a broad standard, not only is it clear that every covered institution could easily be deemed to have a *dominant policymaker*, but it is difficult to imagine how any covered institution could avoid that label.

The overly broad proposed definition would create regulatory uncertainty most obviously for family-owned and other closely held covered institutions even though each has already been subject to close scrutiny in the chartering and deposit insurance qualification processes and is subject, on an ongoing basis, to appropriately strict corporate governance bylaw provisions. But the proposed standard's broad *dominant policymaker* definition is hardly limited to large and majority shareholders. At covered institutions with more broadly distributed equity, most any CEO and broader executive group would likely fall within the proposed standard's broad *dominant policymaker* definition – particularly, as is common, if a covered institution's management solicits shareholder proxy votes.

The proposed standard offers no explanation or guidance as to how directors may accurately identify a potentially dominant policymaker or protect themselves from one's undue influence – or, equally importantly, as to how an examiner may evaluate a director's efforts to ensure his or her independence. As a result, the proposed standard would effectively turn existing fiduciary standards on their head and create a rebuttable examiner presumption that every director is, absent evidence to the contrary, unduly influenced by some dominant policymaker.

No director's judgment should, as the proposed standard risks, be presumed to be impaired based on the mere existence of a dominant policymaker, and we strongly urge FDIC to withdraw the proposed standard.

Select and Appoint Qualified Executive Officers

The Proposed Guidelines provide that, a "board must select and appoint executive officers who are qualified to administer the covered institution's affairs effectively and soundly." Broadly speaking, selecting a chief executive officer (CEO) is among a board's most critical functions, and, in some states, a non-CEO executive's hiring may require board approval. However, most often, a CEO is ultimately responsible for selecting an institution's other executives. Relieving a covered institutions' CEO of the authority to select other executives with whom the CEO will work closely on a daily basis and who the CEO believes will best serve the institution risks undermining the smooth functioning of many covered institutions. Furthermore, FDIC should be careful to not establish a standard that could be easily misinterpreted to suggest a board has a responsibility to effectively guarantee the performance of any specific executive.

We encourage FDIC to withdraw the proposed standard.

Self-assessments

FDIC proposes to require that a board "conduct an annual self-assessment evaluating its effectiveness in meeting" the Proposed Guidelines. Requiring a board to evaluate its compliance with such highly prescriptive enforceable standards would chill director candor and would reduce what are now healthfully robust, dynamic discussions to a fruitless check-the-box exercise.

We encourage FDIC to withdraw the proposed standard.

Committees of the Board

Throughout the Proposed Guidelines, FDIC conflates the distinctly different roles of a board and management. FDIC does the same here when describing the responsibilities of board committees. For example, the Proposed Guidelines require that a covered institution's Audit Committee "[approve] all decisions regarding the appointment or removal and annual compensation and salary adjustment for the CAO". Similarly, the Proposed Guidelines require that a covered institution's Risk Committee "Review and approve all decisions regarding the appointment or removal of the CRO [] and ensure that the CRO's compensation is consistent with providing an objective assessment of the risks taken by the covered institution."

Too, by and large, a covered institution's board should be free to determine what board committees are necessary and appropriate to support its prudent and efficient oversight based on the complexity, strategy, and risk appetite of its institution.

We encourage FDIC to withdraw these and similar standards that vastly exceed prudent corporate governance standards laid out in state law, applicable model bylaws, and OCC's and FRB's relevant heightened corporate governance standards and would saddle directors serving on board committees with duties best carried out by management.

BOARD AND MANAGEMENT RESPONSIBILITIES REGARDING RISK MANAGEMENT AND AUDIT

FDIC proposes to permit a covered institution with a parent company to adopt and implement all or part of its parent company's risk management program that satisfies the Proposed Guidelines *only if the risk profiles of each entity are substantially similar*.

What constitutes *substantially similar* under the Proposed Guidelines is unclear. Yet, the proposed standard would be unduly prescriptive however the term is defined because the proposed standard would effectively prohibit a covered institution from adopting *any* part of a parent company's risk management program if the entities' risk profiles are not substantially similar – irrespective of whether such dissimilarities have any bearing on the prudence of adopting any part of a parent company's risk management program.

A board should be free to determine what aspects of a parent company's risk management framework should also be applied to the institution, even if the entities have somewhat different risk profiles. Common elements in risk management frameworks at the bank and holding company levels strengthen enterprise-wide compliance and risk management program synergies.

We strongly encourage FDIC to fully withdraw the proposed standard. At a minimum, FDIC should strike the *substantially similar* qualifier from this and any similar standard FDIC may develop.

Risk Profile and Risk Appetite Statement

The Proposed Guidelines provide that a covered institution should review its Risk Appetite Statement (RAS) quarterly. Contrastingly, OCC requires that its covered institutions review their RASs at least annually – more frequently, as may be necessary based on the size and volatility of relevant risks and any material changes in the institution's business model. FRB's periodic RAS review expectation is even less stringent. By requiring an institution to review its RAS far more frequently than is necessary, FDIC risks turning an important risk management exercise into a check-the-box activity.

We encourage FDIC to withdraw the proposed standard. Alternatively, we encourage FDIC to adopt a mandatory RAS review frequency of not less than one year.

Processes Governing Risk Limit Breaches

FDIC proposes to require that a board establish processes requiring front line units and the independent risk management unit to "identify known or suspected violations of the [RAS], concentration risk limits, and front line unit risk limits" and "distinguish breaches based on the severity of their impact on the covered institution." The proposed standard would further require that these units expressly inform "front line unit management, the CRO, the Risk Committee, the Audit Committee, the CEO, *and the FDIC*" of such developments and suspected developments and describe "the severity of the breach, its impact on the covered institution, and how the breach will be, or has been, resolved."

The proposed standard is woefully overbroad and conflates the distinctly different roles of front line units, front line unit management, executive management, and a board. As a primary matter, requiring any component of a covered institution to report *suspected* violations of the RAS, concentration risk limits, and front line unit risk limits – or violations of law or regulation, as discussed below – *to the FDIC* would immediately induce a flood of unnecessary and immaterial notices that overwhelms FDIC's available resources to evaluate and provide guidance on such issues where appropriate.

Furthermore, under the proposed standard, front line and independent risk management units would be tasked with reporting such incidents or suspected incidents *directly to FDIC*, bypassing front line unit management, executive management, and the board. Even if FDIC clarified the format and avenue through which it expects front line and independent risk management units to provide such reports, the proposed standard would remain wholly inappropriate because it effectively requires front line and independent risk management units to act with the insight, expertise, and diligence of front line unit management, executive management, and a board and to effectively usurp their authority to direct and oversee the covered institution's responses to such incidents.

We encourage FDIC to fully withdraw the proposed standard. At a minimum, FDIC should amend the proposed standard to limit identifiable violations of the RAS, concentration risk limits, and front line unit risk limits to only known, material violations and to make such violations reportable to the FDIC only by a board at the board's discretion.

Processes Governing Identification of and Response to Violations of Law or Regulations

Similarly, FDIC proposes to require that a board establish processes requiring front line and risk management employees to "identify known or suspected violations of law or regulations." Again, FDIC's proposed standard is overly broad and conflates the role of a board and management and unnecessarily tasks the board with a responsibility best carried out by management. We encourage FDIC to fully withdraw the proposed standard. At a minimum, FDIC should amend the proposed standard to require that a board direct management to develop relevant policies that are subject to the board's review and adoption and limit identifiable violations of law or regulation to only known, material violations.

Need for a Reasonable Mandatory Compliance Transition Period

Under the Proposed Guidelines, once deemed a covered institution, an institution would immediately be subject to FDIC's additional heightened corporate governance standards – unless FDIC provides otherwise on some undefined, ad-hoc basis. However, no institution could prudently overhaul its corporate governance structure and practices to meet FDIC's wide-ranging, highly prescriptive proposed standards overnight. For example, identifying, vetting, and installing new directors can take more than a year.

Furthermore, under the Proposed Guidelines, a covered institution's existing directors could be held personally liable for their institution's failing to do the impossible. As a result, FDIC's adopting the Proposed Guidelines or similar additional heightened corporate governance standards without providing for a reasonable mandatory compliance transition period would set off a stampede of exiting directors at institutions both above and near the covered institution threshold.

If additional FDIC heightened corporate governance standards are reasonably necessary, we strongly encourage FDIC to make a reasonable mandatory compliance transition period part of any subsequently revised proposal. Such a mandatory compliance transition period should be at least two years from FDIC's adoption of such standards or from an institution's becoming a covered institution, whichever is later.

Conclusion

Thank you for your consideration of our views and recommendations. The Proposed Guidelines would fundamentally reshape prudently managed, already closely supervised institutions' corporate governance and carry both obviously material and unpredictable risks. We encourage FDIC to fully withdraw the Proposed Guidelines and to be patient, thorough, and thoughtful as it considers next steps. Please do not hesitate to contact me.

Sincerely,

[redacted]

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