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EY Center for Board Matters

Federal Reserve Board Corporate Governance Proposal

A summary for boards of directors and management

Background

January 2018

On August 3, 2017, the Federal Reserve Board (FRB) distributed an invitation for public comment on a corporate governance proposal to address supervisory expectations related to the effectiveness of boards of directors.

This proposal follows a multiyear review by the FRB focused on board practices at the largest banking organizations and aims to address key challenges identified, including:

- Difficulty distinguishing supervisory expectations for the board versus senior management
- Concern that the board's time and resources may be directed away from their "core" responsibilities
- Difficulty preparing and/or participating in board meetings given quantity and complexity of information

The following discusses the key focus areas, scope, implications and questions that boards and management should be considering.

	Key focus areas	Scope
Proposed board effectiveness guidance[1]	Clarifies the roles of the board versus senior management and highlights five key attributes of board effectiveness which would form a supervisory framework going forward. (See next page for five key attributes of effective boards.)	All bank holding companies (BHCs) and savings and loan holding companies (SLHCs) with total consolidated assets of $50 billion or more, as well as systemically important nonbank financial companies designated by the Financial Stability Oversight Council for supervision by the Federal Reserve.[2]
Revision of existing Federal Reserve supervisory expectations for boards	A review of supervisory expectations and regulatory requirements in existing Supervision and Regulation letters to better align with the Federal Reserve Board's supervisory framework and eliminate redundant, outdated or irrelevant supervisory expectations.	Boards of directors of BHCs and SLHCs of all sizes: • All domestic banks and SLHCs (including insurance and commercial SLHCs) with total consolidated assets of $50 billion or more: supervisory expectations would be eliminated or revised to better align with the five attributes of effective boards outlined in the proposed board effectiveness guidance (see next page). • All domestic banks and SLHCs (including insurance and commercial SLHCs) with total consolidated assets less than $50 billion: supervisory expectations would be eliminated or revised to better align with Supervision and Regulation letter 16-11, "Supervisory Guidance for Assessing Risk Management at Supervised Institutions with Total Consolidated Assets Less than $50 Billion."
Revision of Supervision and Regulation letter 13-13/CA 13-10, "Supervisory Considerations for the Communication of Supervisory Findings"	Clarifies how supervisory findings (Matters Requiring Immediate Attention (MRIAs)/Matters Requiring Attention (MRAs)) will be communicated to an institution's board and senior management in order to support the board's core responsibilities.	All financial institutions supervised by the Federal Reserve (including BHCs, SLHCs, state member banks, US branches and agencies of Foreign Banking Organizations and systemically important nonbank financial companies designated by the Financial Stability Oversight Council for supervision by the Federal Reserve).

Proposed board effectiveness guidance — Key attributes of effective boards

1. Set clear, aligned and consistent direction regarding the firm's strategy and risk tolerance
2. Actively manage information flow and board discussions
3. Hold senior management accountable
4. Support the independence and stature of independent risk management (including compliance) and internal audit
5. Maintain a capable board composition and governance structure

Key implications

Proposed board effectiveness guidance	The guidance establishes key attributes of board effectiveness rather than standardized expectations and supports the effort for boards to achieve their maximum effectiveness reflective of their firm's characteristics and risk profile. This guidance also discusses the ability of supervisors to rely on various sources of information to assess board effectiveness, such as firm-provided materials, examinations and self-assessments. The Federal Reserve Board would implicitly expect that firms confirm that they are meeting these requirements on an annual (if not more frequent) basis depending on the size and complexity of the organization. This means that firms may be expected to evidence how their corporate governance delivers against the five key attributes of effective boards, including where they are making any necessary enhancements. Non-executive directors may be questioned on how well the board or committees are delivering on the aforementioned expectations; regulators may ask for concrete examples evidencing the delivery as well.
Revision of existing Federal Reserve expectations for boards	Review will consist of two parts: - Review of supervisory expectations of boards in 27 existing Supervision and Regulation letters - Review of requirements and supervisory expectations in FRB regulations or interagency guidance to determine expectations that may be revised or rescinded As a consequence of these revised or rescinded expectations, boards and committees may need to revise its charters, meeting calendars and reporting to align to the redefined core responsibilities. Boards will also want to go through an exercise to determine the amount of time gained from these changes and to reassess the nature and extent of topics on their board and committee agendas. **The second phase of interagency regulation assessed for revision/elimination will be released for notice and comment at a later date.**
Revision of Supervision and Regulation letter 13-13/CA 13-10, "Supervisory Considerations for the Communication of Supervisory Findings"	Boards would better understand which supervisory findings require their active oversight versus findings directed to senior management, which require more routine oversight. Leveraging additional time gained as a result of refined responsibilities, boards and committees may identify other oversight issues where they could dedicate additional time and further allow the executive and non-executive directors to focus on central and strategic responsibilities. While not necessarily responsible for taking corrective action to remediate the findings, the board would be expected to hold senior management accountable for addressing the MRIA or MRA. MRIAs or MRAs would only be directed to the board if they are related to corporate governance responsibilities or where senior management does not take appropriate action to address the finding. For foreign banking organizations that do not have a US domiciled board, supervisory findings pertaining to US operations governance would generally be directed to their US executives responsible for the foreign banking organization's US operations, although examiners have the discretion to direct it to the foreign banking organization's global board.

Key questions to consider

Boards of directors

1. How do your current board practices align with the five attributes of effective boards outlined in the proposed board effectiveness guidance? What actions or plans are underway to self-assess the board and its effectiveness in meeting its core responsibilities as defined by the five attributes? What are the revised expectations of management and have these been communicated?
2. What steps is the board taking to demonstrate its effectiveness in confirming that the firm's long-term strategic direction is closely aligned with its risk tolerance, risk management framework and significant policies? Have the risk appetite and tolerances been embedded into day-to-day decision-making?
3. Is the type of information provided to the board, both written reports and verbal presentations by management, sufficient to discharge its core responsibilities? What is the nature and extent of involvement by the chair or members in setting board agendas?
4. What is the nature and extent of the effective challenge performed by the board to provide appropriate challenge to senior management's activities and decision-making? What specific skills or competencies may need to be strengthened to deliver on the expectations of the five key attributes?
5. What steps do you need to take given the significant shift away from the "board and senior management" as a single entity? Consider implications on the following:
   a. Mandates/charter for committees and/or boards
   b. Cadence and protocols for committee and/or board
   c. Reporting and information flows to committees and of boards
   d. Staffing and headcount levels

Senior management

1. Has senior management assessed the impacts of the proposed guidance on their roles and responsibilities? Are changes needed to distinct board and senior management expectations to be in line with the proposed board effectiveness guidance? Have you reassessed the roles, responsibilities and reporting structure across the three lines of defense? Are all functions appropriately resourced with the necessary training and experience, and is there appropriate succession planning being completed for senior executives?
2. What steps have been taken to confirm that strategic planning, financial planning and capital planning processes are fully aligned with the established risk appetite and tolerances of the firm?
3. How have nonfinancial and new or emerging risks been integrated into the firm strategy, risk tolerances, risk appetite and risk management framework?
4. What is the expected impact of this proposed guidance on reporting packages to senior executives and/or the boards?
5. What are potential training opportunities to educate senior management on the distinction of their responsibilities versus the board? Are there potential opportunities to rationalize management committee structure accordingly?

The comment period was extended to February 15, 2018, and we anticipate guidance sometime thereafter. Refer to federalreserve.gov to read the full proposals.

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1. The proposed board effectiveness guidance would be used in connection with the supervisory assessment of board effectiveness under the proposed Large Financial Institution (LFI) rating system, which was issued for comment along with this proposal. Board effectiveness would be evaluated as part of governance and control, one of three components in this rating system that also includes capital planning and positions and liquidity risk management and positions.
2. The proposed board effectiveness guidance would not apply to US Intermediate Holding Companies (IHCs) of Foreign Banking Organizations established pursuant to Regulation YY. Guidance related to IHCs is anticipated at a later date.