The Federal Reserve Breathes Fresh Air into Its Corporate Governance Guidance

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The Federal Reserve's **proposed supervisory guidance on corporate governance** is a breath of fresh air that should encourage banking boards to focus on their core responsibilities and avoid blurring the distinctions between executive and non-executive duties. It is also a signal that supervisors intend to move away from the blunt "check-the-box" approach to corporate governance that has especially burdened banking boards in recent years. We applaud this rebalancing in supervisory approach.

The following comments on this positive development are offered in the hope that the guidance, when finalized and as implemented, will avoid an overly prescriptive, "one-size-fits-all" approach.

Risk Is the Corollary of Reward

We understand why the proposal is focused on and frequently refers to risk management, risk tolerances and effective compliance. Those areas require constant attention from all responsible. Because risk and reward should be tightly connected, however, the guidance should just as frequently remind boards of their core responsibility to work with management to set, and hold management accountable for executing, an appropriate strategy for the generation of adequate returns. Sustained profitability safeguards capital, which, in turn, underpins a firm's ability to attract more capital and provides the best security for depositors and taxpayers. Sustained profitability also best enables banking organizations to intermediate capital and transform maturities so as to bolster economic growth. We should not lose sight of the fact that we want our banks to make money for their shareholders too (who are largely pension plans, mutual funds and other widely dispersed owners).

One Size Does Not Fit All

The proposal's recognition that effective boards have a "composition, governance structure, and established practices that support governing the firm in light of its asset size, complexity, scope of operations, risk profile, and other changes that occur over time" should be a guidepost to inform the Federal Reserve's overall implementation of the principles. A "one-size-fits-all' approach should be avoided. Taking as examples the proposal's discussions of board self-assessments and lead director roles, we encourage less prescription and more principle.

Self-Assessments

Self-assessments should remain flexible and confidential. All responsible banking boards already conduct self-assessments in the manner that best suits the firm's nature and culture. Those self-assessments are highly sensitive exercises in inter-personal relations that balance candor with respect in order to spur improvement while preserving collegiality. Tying the assessment to any prescribed criteria, even general ones like the proposal's five factors, and even suggesting the results be shared with supervisors, would chill discussion and defeat the object.

Lead Directors

Firms should retain discretion to define the scope of the lead director role. There is very little regulation of the role of lead director, and the approaches of different firms and best practices in corporate governance evidence an array of effective ways to empower lead directors. The proposal refers to the specific powers of setting agendas and convening meetings. We suggest that each firm should be permitted to

design and update the powers and responsibilities of the lead director role as suits the needs of the firm from time to time.

Board Access to Timely Contextual Information

The Federal Reserve has marked asymmetry of information as one of the challenges facing boards, and this is a key and inherent challenge facing all boards. The information asymmetry is in fact the inevitable result of the distinction between the responsibilities of executives and non-executives. Executives spend all day every day in the details and are paid to do so. Non-executives do not and are not. Instead, the non-executive responsibility is to spend time to learn enough about the business such that, combined with collective diversity of skills and sufficient independence of the board as a whole, they will be equipped to ask the right questions even without executive-level access to information. The cornerstone of this responsibility is board independence, and we would submit that the principles and detailed rules laid down by stock exchanges provide more than is required to ensure sufficient independence at the board level to address the unavoidable information asymmetry. Any attempt to further prescribe ways to address the information asymmetry is liable to blur once again the distinction between executive and non-executive duties, which the proposal seeks to avoid.

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These suggestions and comments notwithstanding, we believe the Federal Reserve's proposal charts the right course for getting banking boards "out of the weeds" and into the "big issues," as noted by Governor Powell. We hope that the proposal's intelligent and nuanced approach to governance will be fully reflected in the final guidance.

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