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Bank Directors: Heightened Expectations and Blurred Lines in a Changing Regulatory Framework, A Conversation from The Clearing House Annual Conference (Moderators: Lissa L. Broome and Derek M. Bush)

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A CONVERSATION FROM THE CLEARING HOUSE ANNUAL CONFERENCE

I. INTRODUCTION

On November 21, 2014, the Center for Banking and Finance at the University of North Carolina School of Law hosted a dialogue on heightened expectations and blurred lines for bank directors in a changing regulatory environment at The Clearing House's Annual Conference.[1] Biographical information about the moderators and the panelists is set forth before the transcript of the dialogue begins.

Moderators

Lissa L. Broome is the Wells Fargo Professor of Banking Law at the University of North Carolina School of Law and also the Director of the Center for Banking and Finance.

Derek M. Bush is a Partner at Cleary Gottlieb Steen & Hamilton LLP, where his practice focuses on advising domestic and international financial institutions and foreign sovereigns regarding U.S. bank regulatory matters and legislation.

Panelists

Michael S. Helfer is the Managing Director of The Ice Glen Group LLC and former Vice-Chairman, General Counsel, and

1. The Clearing House is the oldest banking association and payments company in the United States, having been established in 1853. It is owned by the world's largest commercial banks. The Clearing House Payments Company L.L.C. provides payment, clearing, and settlement services to its member banks and other financial institutions, clearing almost $2 trillion daily and representing nearly half of the automated-clearinghouse, funds-transfer, and check-image payments made in the United States. The Clearing House L.L.C. is a nonpartisan advocacy organization representing the interests of its owner banks on a variety of important banking issues.

Corporate Secretary of Citi. He is a member of the boards of directors of Banamex, the second largest bank in Mexico, and of EP Energy Corp., an oil and gas exploration and development company.

Jewell Hoover is Principal at Hoover and Associates, a Director at Fifth Third Bank, former OCC District Deputy Comptroller, and co-author of *The Ultimate Guide for Bank Directors*.[2]

Oliver (Ollie) Ireland is a Partner at Morrison & Foerster LLP, where his practice focuses on retail financial services and bank regulatory issues.

Martin (Marty) Pfinsgraff is the Senior Deputy Comptroller for Large Bank Supervision with the Office of the Comptroller of the Currency. He also serves as a member of the OCC's Executive Committee and the Committee on Bank Supervision. He previously served as Deputy Comptroller for Credit and Market Risk.

II. HEIGHTENED EXPECTATIONS FROM THE REGULATORS

Bush: This is a topic that really does not require a lot of introduction for a few reasons. One is it has been either an explicit or an implicit part of many of the discussions we have had at earlier sessions of The Clearing House Conference. There has also been a steady stream of guidance, both at the national level and the international level, that I know everyone is focused on. This guidance includes not only the OCC's Heightened Standards,[3] but also the Basel Consultative Document from October 2014, [4] the Group of Thirty paper from 2013,[5] and an intriguing speech by Federal Reserve Governor Tarullo from the summer of 2014,[6] posing a question about whether we

2. CATHERINE A. GHIGLIERI & JEWELL D. HOOVER, THE ULTIMATE GUIDE FOR BANK DIRECTORS (AuthorHouse 2011).

3. OCC Guidelines Establishing Heightened Standards for Certain Large Insured National Banks, Insured Federal Savings Associations, and Insured Federal Branches, 79 Fed. Reg. 54518 (Sept. 11, 2014), *available at* http://www.gpo.gov/fdsys/pkg/FR-2014-09-11/pdf/2014-21224.pdf.

4. BASEL COMMITTEE ON BANKING SUPERVISION, CONSULTATIVE DOCUMENT: CORPORATE GOVERNANCE PRINCIPLES FOR BANKS (Oct. 2014), *available at* http://www.bis.org/publ/bcbs294.pdf.

5. GROUP OF THIRTY, A NEW PARADIGM: FINANCIAL INSTITUTION BOARDS AND SUPERVISORS (Oct. 2013), *available at* http://www.group30.org/images/PDF/Banking_Supervision_CG.pdf.

6. Dan K. Tarullo, Member, Bd. of Governors of the Fed. Reserve Sys., Remarks at the Association of American Law Schools Midyear Meeting: Corporate Governance and Prudential Regulation 17–18 (June 9, 2014) (transcript available at

should change the way we define the fiduciary duties of directors. Most importantly, for the last few years this is really an area where The Clearing House has been a leader in the industry discussion of director duties and their role in corporate governance of banks. You probably know that The Clearing House has released an exposure draft of its Guiding Principles for Enhancing Banking Organization Corporate Governance, originally issued in June 2012, republished in an updated form in September 2014,[7] on which The Clearing House is soliciting comments. The Guiding Principles have been a really important part of the discussion and a way for the industry to help shape its response to the ongoing guidance and standards being promulgated by supervisors and other policymakers.

So picking up on Comptroller of the Currency Curry's speech given at the Annual Conference,[8] Marty, from your perspective, thinking about the OCC's Heightened Standards, what would you draw attention to as the highlights of the Heightened Standards? The articulation of director duties and expectations in the original proposal was a bit of a lightning rod for the industry and drew a lot of comments. From where you sit, how do you think about that?

Pfinsgraff: Some thought we were seeking, in some way, to change the role of directors and I think that is clearly not the case. We were seeking to clarify, not change the role of a director. We continue to see the role of the board as hiring the CEO, being involved in approving strategy, approving key policies such as risk appetite statements, and to have audit report into the board. In addition to the roles just mentioned, we also see the board having a role in validating that the risk framework that the organization has put in place is operating appropriately. Finally, from a risk management perspective (and we had a fair amount of debate on this internally), as has been discussed in some international white papers, should risk management

http://www.federalreserve.gov/newsevents/speech/tarullo20140609a.pdf).

7. THE CLEARING HOUSE, GUIDING PRINCIPLES FOR ENHANCING BANKING ORGANIZATION CORPORATE GOVERNANCE (Exposure Draft Sept. 2014), *available at* https://www.theclearinghouse.org/issues/banking-regulations/dodd-frank/corporate-governance/20140910-tch-exposure-draft-on-corporate-governance.

8. Thomas J. Curry, Comptroller of the Currency, Remarks at the Annual Conference of The Clearing House Association (Nov. 21, 2014) (transcript available at http://www.occ.gov/news-issuances/speeches/2014/pub-speech-2014-160.pdf).

report into the board? Some observers have answered that "yes," but we answered that "no." Risk management should not report directly into the board. We see audit as a check and balance. Obviously, it is looking backward and validating as to whether certain actions took place. Were disclosures appropriate? Was reporting appropriate? So, audit is a look-back function. We think it is very appropriate for audit to report directly into the audit committee of the board. We see risk management very differently. It includes both current and prospective judgments being made. Oftentimes, in most organizations on a day-to-day basis, there is some reconciliation required between the front line and risk management. That is a management function. That is not a board function. Having said that, we do think Chief Risk Officers ("CRO") need to have unfettered access to the board and to the risk committee of the board, and that is more or less the language we used in the guidelines. We concluded that risk management is a management function that reports to the CEO. The CEO needs to arbitrate on occasion between the front line and the risk management function. If there are issues that arise between the CEO and the CRO, the CRO can then take those to the board. So, this was not an attempt to change structure. I think it was an opportunity to clarify where we felt based upon some of the issues that arose during the crisis, clarification was necessary or appropriate.

Broome: Marty, the guidelines talk about the board "challenging" management. Could you give us some sense of what you think that looks like and how that is going to affect the board relationship? How is the examiner going to measure that or establish whether that challenge has occurred?

Pfinsgraff: There were a lot of questions as to whether the expectation of board challenge is somehow going to change the dynamics with the board. Certainly when we look at challenge, we think it occurs in multiple ways across every organization. We see challenge occurring where it arises as boards discuss strategy or boards discuss problem issues. So, it can occur in a board meeting. I would say it often occurs off-line. It occurs in one-on-one conversations that the lead director or the chairman of the board has with the CEO. It occurs in discussions that heads of risk audit or governance committees have with the CEO or senior management, and that is typically where that occurs. So, interestingly enough, those are usually not areas where regulators are present. As we look at where there has been the most progress in the six or seven categories that we think comprise our Heightened Standards, the most progress has been made in credible challenge by the board. You might ask, "How in the heck are you doing that? You just said, you are not there when that occurs." One of the things that my predecessor, Mike Brosnan, did when rolling out Heightened Expectations in 2010, was to require that our Examiners in Charge ("EIC") meet informally with boards, individual directors, risk committees, and audit committees on a regular basis. That is now taking place. I'm not saying it is perfect, but it is absolutely part of the evaluation process of our examiners in charge. What we have seen come out of those informal discussions is a better understanding by our examiners in charge of what is taking place informally in those off-line sessions between chairmen, lead directors, heads of committees, and management—including the CEO. I have also gotten feedback from directors that this has been helpful to them in terms of understanding our concerns, the priority of our concerns, and therefore, being in a better position to provide challenge. So, we are seeing progress in this area. I think that for most boards challenge occurs in meetings, but mostly off-line. We have been very encouraged by the progress that we have seen.

Bush: There is a parallel expectation that sometimes plays out and can arise in exams, which is an expectation of credible challenge by risk functions to a line of business, with institutions feeling like the way that a supervisor can measure a credible challenge is by looking to how many times a business initiative or transaction was denied by a risk function. In other words, show me the results of this challenge in some number of times when the challenge actually had effect. Is there a risk, Mike and Ollie, that examiners will want to see boards turn something down to prove the challenge? Or, is it going to be enough that the supervisors can measure the behind the scenes discussions and get at the more intangible effect?

Ireland: The risk function in the bank should be working with the business function and they should work those things out along the way. For it to get to the point where somebody has a product that they want to put in the market and the risk people say, "You cannot put that product in the market," then there is probably a failure in communication. I think the same thing is true in the board process. So, if you have some sort of a quota of rejected proposals, I think you are going completely in the wrong direction.

Helfer: I think that sometimes there will be a proposal which will work its way through and get to a risk person too late. I think Ollie's point is right. If the company spent a lot of money preparing a product or business plan and then it finally gets to a senior risk person that rejects it, there probably has not been enough internal communication. But in general, risk has to work with business, even as it is an independent monitor of the business.

Stepping back, when regulators and supervisors first began talking about challenge before there were any proposals, it started informally through the examination process. I think there was a lot of concern about what challenge means. Challenge sounds confrontational. Is that what is expected? I know some examiners were told by banks, "Well, tell me how many challenges you want per board meeting and we will make sure they are there. What is the quota? How many turn downs do you need? We will make proposals we know will be turned down and you want the word 'challenge' in every other paragraph in the minutes." But, as described by Marty, the OCC seems to have a reasonably sophisticated understanding of how challenge works. As long as that is communicated, as long as you understand that challenge happens in the committees, it happens in board discussions, it happens in other discussions, and as long as the inquiries by the examination staff are to that effect, challenge can be discussed and measured.

If, however, an examiner comes in and says, "When was the last time you challenged management?" You are going to get a very defensive reaction. The directors are going to say, "Hey we need some of this challenge stuff. Solve this problem for me." But, if the examiners are engaging in a sophisticated discussion of -- "What is going on with the business? What are the things that are coming up?" -- to get a more nuanced and subtle understanding, it can be very productive for the institution and the directors.

Bush: This sounds like an implementation challenge because the way you described it was very nuanced. I think we have all experienced that for an examiner sometimes, if something is not written down, it does not exist. It is going to be very difficult to find evidence of "challenge" for all the reasons we just talked about. But, is there room in writing the minutes to address this issue? Is this something boards should think about in the draft minutes that they review?

Helfer: There has been a progression. I am old enough that when I started practicing law about 100 years ago, minutes were a long list of who actually came to the meeting, said the board passed the following resolutions, the board talked about a bunch of stuff, and then they left. The theory was, the less you say, the better. Over time, at least in the banking business, that has become dramatically different. Boards want more of the discussion reflected in the minutes. The regulators want to see more of the discussion reflected in the minutes. As long as the supervisors are not looking for the number of times the word "challenge" or any other particular word is used, I think this is a good development.

I know in some institutions, the committee minutes are also increasingly detailed and are provided to all the directors even those that are not on the committee. They just go into the board book. I think that is a good idea too, because it gives people who are not on the audit committee, not on the risk committee -- in addition to the reports they get, which are sometimes very summary -- they actually get the minutes of the committee meeting and see the nature of the discussions. So, I think there has been an effect on the minute writing.

Broome: Jewell, you sit in a boardroom. In your experience, is your work as a board member always reflected in the minutes? And is what happens in the boardroom all of the board's work or does some of it happen outside the boardroom?

Hoover: Typically, board minutes do not reflect all the discussions in the boardroom or in the committee meetings. It is just not possible to capture everything. We have talked about a credible challenge to management. We need a credible discussion on various issues and you cannot capture all of that because there is a healthy debate that is ongoing in meetings. If the examiners are looking at the minutes, they cannot ascertain everything that has gone on in the meeting.

In terms of those credible challenges or discussions, I agree with the other panel members that a great way of doing that is to have informal meetings with the regulators. At Fifth Third, we do that. We try to have a very provocative and interactive communication process on a regular basis with the regulators. We meet with our EIC and our chair of the risk committee. We meet with the examiner in charge and other departmental areas. We talk about things that are going on within the bank, the expectations of the regulators, and what is going on within the boardroom. So I think that what is presented in the board minutes is a way of letting the regulators know our thought processes.

Broome: What about documenting the other conversations that might occur off-line? Would that be helpful for the regulators? Should you note to the file that "I met on this date and talked with so and so, and made a challenge." Is that something that the regulators are going to be looking for or that the lawyers would advise their clients to make sure they are documenting?

Pfinsgraff: I had the privilege of being on eight or nine boards. I am on two today, but no bank boards. When I see how that process plays out, challenge begins with the questions that directors ask, typically during the meetings or even sometimes off-line, but the challenge occurs if they do not feel they have gotten fulsome or accurate answers. In either of those cases, if the answer is not fulsome or accurate, we do have an expectation that a director will follow-up to make certain that they get a fulsome and accurate response to those questions. It is in that area, when we have these discussions with Jewell or other directors, where we get a perspective that is shared with us—here are the questions that are being asked, and then here is the follow-up that we are expecting to see as a director to answer that question in a fulsome and accurate way. Clearly, if over time you are not getting what you consider to be fulsome and accurate responses, there have to be consequences from that. As a director, if you are saying, "This does not seem right, we are not getting either the right responses, the right level of response, or we keep getting surprised," then there is a problem. This whole initiative around heightened standards came about because serving through the crisis we saw too many boards where there were surprises and the boards did not necessarily have a perspective on the aggregate level of risk that the institution was taking. The board members may not have been completely knowledgeable about certain product risks that were being incurred or were unfamiliar with what certain lines of businesses were actually doing. This was certainly a way for us to try to reinforce and clarify that those are things that we expect directors, certainly at the committee level, to have a decent understanding of those issues.

Bush: The board's oversight and the risk committee's oversight of risk is obviously a key part of the standards. Jewell, just from your own experience, how do you see the board and its risk oversight function?

Hoover: Risk management has evolved over the years. Risk management today is not your father's risk management in terms of identifying, measuring, monitoring, and controlling risk. Risk management has evolved to enterprise risk management and the fulsome, holistic process of managing it. That culture of risk management today is embedded in the entire board process, not just the risk committee. Clearly, the majority of risk management has been delegated to the risk committee of a board, but it is also important that every board member be involved in risk management in terms of establishing what the risk appetite is and what control systems the bank has around that process.

Governor Tarullo gave a speech in June 2014 where he said that risk is not reducible to a single metric.[10] I agree with that. Boards make risk decisions in almost everything that they do. It is fairly amorphous. If we could reduce it to a metric we could say, "This is it." We could identify it, isolate it, and then put a box around it. But it is never that simple. So I think the board has to be fully engaged in the risk process. The paradigm has changed. It is a very complex process. So, delegating it to the risk committee is simply not enough. I think

10. Tarullo, *supra* note 6, at 9.

regulators expect that all board members have a fiduciary responsibility to look at risk.

Risk is also a bifurcated process with compliance now. In the past, we would have had our prudential regulator for compliance, but now we also have the CFPB. So we have to look at compliance risk from not only a technical standpoint, where we comply with consumer laws, but also, at what is the risk to the consumer. So, it is a holistic process and the board has to be fully involved in that entire area.

Helfer: At the same time, a board that consists entirely of risk experts is a board that has one absolutely critical element of oversight under control, but may not have other elements of oversight under control. So while I agree with Jewell that every board member has to have a basic understanding of the bank's risk appetite, there is also a need on the board for other areas of expertise. I think the questions from the board standpoint, and the regulator's standpoint should be, "Does the board as a whole, have the right set of expertise? Are there people who understand the information technology and cyber-risks? Are there people who understand compliance and control issues?" Not everybody has to be an expert in all of those things. Risk committee members should be completely fluent on the details of risk, but every board member does not need to have that level of command regarding risk.

Pfinsgraff: I echo what Mike just said. When we look at boards and at board composition, we are typically looking for that diversity that he is talking about. Not everybody can be an expert in all areas, in all lines of business, and all activities and kinds of risk that an organization is coming under. So, we are typically looking to see if the board has a question process where you are questioning assumptions that are in a strategy or a plan. You want the right people with the right diversity of experience, whether it is an HR issue, or whether it is a risk management issue in your commodities business (which would be very different from a risk management issue in a retail business, or a bond business). So having a diverse board really gives that perspective of people asking and questioning assumptions, but from a position of their own expertise and what they bring to the table. That really is the essence of why you want to have a diverse board.

Bush: The way you described the expectations of the board to oversee risk and evaluate and approve the risk appetite, it is very difficult to express a concern about that. But in practice, there is probably a perception that the expectation is more granular than that. If directors start to perceive that, is there a risk that we will in fact see boards drift towards a greater number of people with real risk expertise and as risk management gets more sophisticated, directors wanting to understand what they are hearing from the CRO in the meetings? Is there some risk that as a matter of practice that happens even though everyone agrees with the virtue of diversity on the board? I see that Ollie is nodding.

Ireland: Particularly, I see it today in the compliance world. If you can expect granularity and people to actually understand compliance requirements going forward, and compliance is a very substantial risk these days -- retail compliance in particular since the CFPB has gotten involved, but also wholesale compliance -- then you are going to have to know an awful lot of detail to understand it. I think that we are starting to move beyond the board function. I agree with Marty's description of what the board should do. I do not see that they can deal with individual risks in many cases. They can deal with an architecture that is designed to address those risks, but they cannot be in the business of assessing individual risks from individual products in anything but exceptional circumstances.

Broome: Obviously these guidelines are really applicable only to the largest national banks and I am wondering to what extent, Mike, do you think banks that are not formally subject to these guidelines should pay attention to them?

Helfer: I think it would be imprudent for community banks or smaller banks not technically covered to not try to glean some lessons and some guidance about what the regulatory expectations are going to be. The analogy I might use is that the Sarbanes-Oxley requirements did not apply to non-profits, for example, but many large non-profits have looked at the Sarbanes-Oxley requirements and tried to figure out from them what is best practice. So, I think it would be worth taking a look and seeing what you could draw out of those in terms of what regulatory expectations are, and what best practices are. In many ways, as Marty has said and as the Comptroller said earlier in his speech, these guidelines repeat and clarify some pretty standard expectations about what boards do.

Broome: Ollie, how do you think the Fed views these new guidelines and will it apply similar guidelines at the holding company level?

Ireland: The typical culture of the Fed is to take a somewhat more moderate tone than the OCC will take and some of the other bank regulators will take. Are they going to be influenced by it and move in those general directions? I think so.

Bush: There was an interesting discussion at an earlier panel of this conference about the question of culture. Is there a problem that a bank may have a strong overall culture, but a micro-culture that develops within an institution, for example, of traders who feel greater loyalty to their counterparts at other institutions than to their employer? There was this issue of a challenge of how to figure that out and prevent it or deal with it, but from the board's perspective. There is an expectation that the board is going to be part of defining a bank's culture, which already begs the question about how the board should go about doing that. Maybe you could talk a little about how the board should do that generally. Is it realistic to expect the board to be able to figure out something like the micro-culture problem?

Pfinsgraff: I think culture can be measured. I would bet that when Jewell was an examiner, she could go into a bank and figure that out relatively quickly and have an assessment of the culture of that institution, whether it was risk culture, compliance culture, however you want to classify it. Culture is simply the normative behavior of a group of people. We basically can measure that when we observe patterns of behavior. We typically are not looking at transactions, we are looking at patterns of behavior and are trying to evaluate and draw conclusions from those patterns of behavior, not necessarily from specific transactions. I think boards do the same thing. If I were to observe as a director or as an examiner, and I am seeing a pattern of behavior that either goes deep into a particular line of business, to your point, a subculture, and then I can see that pattern of behavior evident at multiple levels in a particular line of business, or when I start to see a pattern of behavior that cuts across lines of businesses, I can then draw conclusions around what is the culture. Again, culture is the normative behavior of a group of people. So, I do think it is something that is measurable. Whether you are a director or an examiner, you are basically looking for recurring patterns of behavior over time, either within or across a particular organization or line of business.

Ireland: I can tell you that when I was at the Fed we had definitive views about the cultures of various banks, including large banks, small banks, and holding companies. If I talked to any supervisory people, they sometimes got quite excited about those judgments and differences in them. When you talk about a sub-culture, it brings back to me the memory of Nick Leeson who was the trader in Singapore who brought down Barings Bank. The interesting thing about it was that the Singapore monetary authority did a report of an analysis of how this happened and the Bank of England did an analysis of how it happened and the reports were not even close. They did not agree with each other on almost anything. If you believe the Bank of England, management should not have caught the rogue trader. If you believe the Singapore monetary authority, management should have caught him, but maybe not the board. I think that is expecting an awful lot of boards, to think that the board can catch kind of rouge trader in all cases.

Helfer: Ollie, to your knowledge, did the Fed communicate its views about the institution's culture to the outside directors of those institutions?

Ireland: I do not think they did as good a job of that as they should have. We had markedly divergent views about some banking organizations and we actually got feedback from the banking organizations indicating that they knew that. I do not think that was well communicated to the boards of directors. I think that the supervisors gave more filtered feedback to the board than was occurring within the Fed organization.

Bush: Most banks perceive themselves as having a strong culture of compliance, with some version of "do the right thing" as a motto. How does the board get a handle on the culture of an institution from sitting in the boardroom, talking to management in the hallway, or even in informal meetings? How do you really understand the bank's culture? Is it the way that supervisors try to understand it—inferences from bad acts—or is there more a board can do?

Hoover: I will revert back to my regulator days. Marty indicated that examiners can tell you, almost to 99% certainty, what a bank's culture is and its personality. The way we made that assessment is if there is a distinction between the bank's written policies and actually what is going on in a bank, then the culture is exactly what is happening on the ground. You can measure that from a board perspective in terms of how many exceptions to policy are there. How many breaches of a certain position or policy do you have?

A board should directly engage with senior management at a certain level in conversations. For instance, the board will have conversations at a board dinner with various levels of management and those conversations can tell you a lot informally about what is going on in an institution. So, if there is a stark difference between written policy and actually what is happening, that is going to tell the board member if there is an adherence to their tone at the top. I think that board members really need to be attuned to that, without overreaching, and probably having appropriate conversations with various levels of management and drilling down in the organization. I think part of your oversight role is to really know what is going on in an institution. I would start with those broad policy precepts versus exceptions, attitudes and behaviors. Those are things that are pretty obvious. You are going to see them. If there is a breach, it is going to stand out, and it is going to come to the board in some type of way in their management information systems.

Ireland: I think that is right. I think there is a problem with the contrary pattern. If you are not seeing that, can you assume that everything is fine? And, I am not sure that is the case.

Hoover: No, that is not the case. I think that you have to be very smart about what you are not seeing and that raises a red flag in itself.

Bush: What can the board do to actually set the culture of an institution, not just to be on the lookout for potential problems in the culture?

Pfinsgraff: At least on the boards I have been on that have worked well, I think it is precisely what Jewell is saying. You look for those instances where you can reinforce either good behavior or ostracize bad behavior. The role of the board goes beyond simply coming up with a set of words for a risk appetite statement, or approving a risk framework, or values. Ultimately, you have an opportunity to observe whether or not the actions on the ground are consistent with those value statements, risk appetite statements, and with what your expectations are. If they are not, then the board should be looking to see, whether there are appropriate consequences to that. And again, I think that works both good and bad. It is reinforcing good behaviors and it is obviously taking action to hold people accountable when there are not good behaviors. You can get a perspective as to whether or not management is coming to you and saying, “Well this is an exception. This went wrong and there are really a lot of reasons for this.” There are always reasons for it, but at the end of the day, if you see a pattern of that behavior, then the board really does need to step up and take actions to make certain that those values and those risk statements are being reinforced both positively and negatively and that people are held accountable.

Ireland: That is probably one of the reasons you emphasized challenge in the guidance.

Pfinsgraff: Yes, exactly.

Broome: Marty, in the proposed guidelines commenters said that perhaps you were looking for boards to be engaged in active management of the institution. Can you describe how you think the final guidelines have dealt with that issue about boards getting into the management side?

Pfinsgraff: We are sensitive to this and we did get a lot of feedback. The focus was primarily around the use of the word "ensure." That word presupposed in the reader's mind, based on feedback, that the board can somehow guarantee a result and that may potentially increase liability. We stopped using "ensure." We changed the language so we used "validate" or other words that do not necessarily imply that the board is providing a guarantee and thereby has to now get engaged in actual management.

When you have an institution with a set of problems that look like they are starting to become problematic for that entity, I do think boards change their behavior. You do validate more. I am certainly seeing this. We have nineteen large banks and we have an average of sixty-five MRAs and probably one or more consent orders that are in place in those organizations. We are not at a highest water mark in that regard, but neither are we where we would like to be, nor at where the institutions would like to be. That is where we are seeing more engagement by the board because the board is cognizant of the fact that you want to get back to a business as usual mode. Oftentimes that means the board needs to step up.

I do think that there are points in time in any organization where things become more challenging. You may have to change management. When you are at those times, the boards are engaged and sometimes it may look like they are crossing the line because they ultimately need to go and validate through the challenge process, but that is part of the process of fulfilling their fiduciary duty. We pulled away. We stopped using "ensure," but I feel a little uncomfortable with that because I think this is a perceptual issue. In practice, we are not looking for boards to guarantee results or step into the role of management, but we do think that when it comes to ensuring that you have a good CEO, ensuring that the risk framework that has been established is appropriate for the size, complexity, and risk profile of that institution, boards have a fairly significant responsibility.

Hoover: I agree with that in terms of boards and oversight responsibility. As a practical matter, a board member always knows the matters requiring immediate attention because they have access to the report of examination where they are discussed. So, every board member oversees a process of remediation for those matters requiring attention. Having said that, are all matters requiring attention created equal? The answer is "no." Boards may have to step up their game in terms of whatever is going on in that institution. For example, in matters requiring attention, a board mandate to inject capital in a bank is going to receive more urgency than one where there is a need to reduce an accounting policy to writing.

In the end, the board is responsible for "ensuring" corrective action is accomplished. I think at some point it may be semantics, but I agree the board has a responsibility to make sure that those things are correct. I think the thing we take away is an awareness of an issue and awareness that there has to be corrective action. Oversight is ensuring that management is executing a corrective action plan. Accountability stops with the board to make sure that it happens.

Bush: The question of the meaning of "ensure" reminds me of how that issue comes up in the context of enforcement and consent orders. When the order says that the board shall ensure x, and the board says, "Oh no, we cannot ensure x and we especially cannot ensure it in a consent order." Sometimes we try to revise the words, but there developed a practice of defining "ensure," to mean "exercise appropriate oversight and management." Sort of the same semantic issue. Mike and Ollie, do you think the final guidance struck the right balance, and, more importantly in practice, will it be implemented with that appropriate balance?

Ireland: I drafted regulations and guidance for part of my life and so I try not to hold it against the drafters. It is very hard to capture exactly what you are trying to do in two or three pages or in a paragraph on the board of directors' role in a more complex document. The concern I have is that the examiners reading the language go overboard. I think that happens more than it should. There may be less control of examiner discretion from Washington than sometimes even the agencies would like and that a lot of the institutions would like.

III. THE BURDEN ON BOARDS

Bush: Let's talk about some of the burdens and other challenges that fall on the board. It does seem that when new regulatory policies are adopted it is increasingly common, as a way to emphasize their importance and make sure they are implemented properly, to have a board approval requirement. For instance, board approval of an AML program or Volcker Rule compliance program, sometimes combined with a CEO attestation. Once the board approval requirement is there, then it continues even as those new requirements become more ordinary course. Is that the right approach, or should the board approval requirement be allowed to evolve or sunset as regulatory regimes are implemented? How significant of a burden is such an approval requirement on the board?

Pfinsgraff: I think it creates a dynamic. Parts of the dynamic are useful and parts of it are a waste of time. I have seen people write that into rules. The people who write it into rules do not necessarily have a holistic view of the board of director's role. It causes management of the organization to spend a lot of time and a lot of effort in making sure they pay attention to those issues, and to that extent the requirement is probably achieving its goal. The package that then gets to the board is probably not, in many cases, meaningfully reviewable because it is simply so voluminous and so detailed that the board can only review it in the most summary way. I do think it would be beneficial at some point to go through and weed those things out periodically because a lot of them were big issues ten or twenty years ago, and probably not in many cases what you want your board focusing on today.

Bush: Jewell, in your experience, are there things that management presents for approval that you think in the back of your mind, "I probably do not need to approve this," but it is a regulation that requires it or some other standard that requires it?

Hoover: Most of the time there is a regulatory requirement that the board approves certain policies and examiners look for that during the examination. I think from a governance perspective, most boards adopt a process where policies are updated on an annual basis. Some policies may have a sunset and some not. But from a holistic standpoint, boards should review all policies to make sure that they are still current; that they fit current lines of business; and that they identify the risks. So, it is a governance process. It is good governance, but also regulators look to make sure that the board has accomplished their fiduciary responsibilities by reviewing and approving those policies. Now, having said that, Ollie said that the volume of it is a lot, and it is. The whole board cannot be expected to read all policies in detail. But on some level, the various committees are familiar with the policies, depending on where that responsibility lies. They can talk with the person who is developing the policy so that particular committee will have a more detailed knowledge of exactly what is there.

Broome: Continuing with this theme of burden on the board -- we are asking the board to do a lot. Mike, during 2008, Citi's board was certainly taxed. How many times do you think it met during that year?

Helfer: Well, the Chairman of the Audit Committee at the time, Larry Ricciardi, who kept track of these things, told me that in 2008, if you add up actual board meetings, board briefings (which are not formal meetings), and audit committee meetings, he participated in eighty meetings during the course of 2008. That hopefully was an extraordinary year. But in times of crises, the board does have to step up. Even in crises that may not be as dramatic as 2008 was, when there has to be a change in management or other personnel action, boards meet a lot and it takes a great deal of time.

Broome: Jewell, in more normal times, describe the number of board and committee meetings that you have and the time you devote to preparing for them, attending them, and following up afterwards.

Hoover: I think this is the new normal. I do not think we will ever get back to where we were pre-recession because the world of banking has changed, the role of corporate governance has changed, and rightly so. I think that boards have to be smarter about how we view risk and how we view governance. I chair the risk committee and I am a member of an audit committee. Between my board and committee meetings in 2014 I had twenty-two face-to-face meetings and another twenty to twenty-five telephone conferences of some length. So, in this new normal, I am looking at between forty to forty-five meetings per year. The time commitment is significant and rightly so, because the information boards have to review to have a "credible challenge" or discussion is simply great and the information is complex. For me to prepare for my quarterly board and committee meetings, I can easily spend three to four days reading the information and digesting it to be prepared to have those conversations at my committee meetings and at the board meetings. This is the new normal and I think that boards can continue to expect that this is going to happen. I think we are going to have even more regulatory requirements and rightfully so. The regulators want boards to build as big a box as possible to control and manage the risk. In order to do that, we are just simply going to have to spend more time.

Bush: If that is the new normal, and there is no doubt a range of the number of meetings and time commitment across different kinds of institutions, does that too influence who likely is going to be willing to serve on a board in terms of expertise and available time? I think in the U.K. there is some suggestion of a concept of a dedicated secretariat, a staff to support the board, beyond what the corporate secretary's office does -- perhaps experts, not external advisors, but dedicated staff for the board. Can you imagine that becoming something that a board would need to get through the work?

Hoover: Yes. We have dedicated staff in terms of our risk committee. They are not dedicated necessarily to the committee, but they spend an inordinate amount of time making sure that we have the right information. I spend time with those designated employees or experts on a monthly basis, or even more frequently with one-on-one touch-base meetings with them in terms of organizing committee work flow, what we are going to discuss, and what is going to be presented. When you get to your committee or your board meeting, it is almost anti-climatic. There is a lot of preparation behind the scenes between board members and the staff at the bank that they have to devote to us in terms of preparing that information. Just think about the sheer complexity of it. There is a whole back room operation dedicated to helping the board get that information and understand it. It is a team effort in terms of the staff at our institutions and a team effort in terms of our board members to have that synergy for making those decisions and participating in those discussions.

Bush: When you talk about the staff, that is the bank's employees and risk management. Could you imagine it going so far as the board having its own staff, separate from bank management? In other words, what about an independent staff to support the directors in their independent role as directors? You would get the materials from the CRO and then you would talk to your own staff about what questions you should be asking.

Hoover: I do not think we should go to the point of having centralized point of contact. I think that what we have now with various staff embedded throughout the bank is working properly. There just has to be a balance between how much is enough and the board members have a responsibility too, to keep that balance there.

Broome: Well the people you are interacting with obviously have the substantive knowledge and expertise to help you. One could imagine an independent staff would then have to duplicate some of that institutional expertise and knowledge.

Pfinsgraff: I do not know how that could work, having completely independent staff. One of the observations I made is that a director needs to figure out through asking questions whether they get fulsome and accurate responses. Well, am I determining whether my staff gave me fulsome and accurate responses, or am I determining whether management and their staff are giving me full and accurate responses. I think ultimately that what you are really trying to test is are you getting the right kind of support and the right responses in terms of accuracy and fulsomeness from management. When you start muddling that up with, "It was my staff that screwed up, it was not that management goofed up," I think that would make things difficult.

Broome: In addition to the folks that Jewell was talking about, Mike, obviously the corporate secretary's function supports the board. Could you describe how that works and how the board decides when it is going to rely on the corporate secretary and when it is going to look to external advisors to bring in?

Helfer: It has been a while since I have acted as corporate secretary, but it seems to me that is the key responsibility of the corporate secretary's office -- which I believe typically should be the general counsel in the organization -- to make sure that the materials that go out to the board are complete and timely, properly summarized, and properly presented. The corporate secretary's office is not going to do its own independent calculations of VAR, for example, but it can make sure that the right stuff is going into the board book, that it is understandable, that people are prepared to present to the board in an understandable way, and that the board book is going out in a timely fashion. That is in addition to all the checklist stuff, making sure that everything that has to get done, does get done.

What Jewell described is very good. A good aspect of corporate governance is where the management assigns to each committee a senior member of management who is responsible for that committee, for making sure that that committee is getting its information, who has a relationship with the chairman, and who talks to the chairman before the meeting of the committee. Or, the general counsel does it with the CEO and the chairman of the board. "What do you want covered? Here is a proposed agenda." So, the CRO would be the senior staff person for the risk committee. The general counsel would be assigned to the nomination and governance committee. The CFO would staff the audit committee, in addition to the role of the independent auditor. By putting that responsibility clearly on a very senior member of management and by holding that person accountable for getting the materials right, having that person create the relationship with the chair of the committee, you very quickly get from the board a sense of whether it is getting what it needs.

Bush: Jewell touched earlier on the board's role in overseeing resolution of MRAs and obviously it gets a copy of the exam report and reports from management on their resolution. A question for Marty. I think it was this fall, an OCC bulletin suggested that the board may even need to, at least in some cases, unearth the root cause of the MRA. Do you have a sort of gloss on what the board's responsibility is to ensure that MRAs are resolved and ideally that they do not reoccur?

Pfinsgraff: First, I would say, it is not the board's responsibility to determine root cause. That is, in fact, one of the 5 C's that we are outlining in the MRA. What is the concern? What is the cause? What are the consequences? What are the corrective actions? What is the commitment that the bank is making to fix it? So, I do not see the board being involved in that that at all.

From my perspective, management's function is to oversee the remediation, the fix, and the follow up on any remediation relative to an MRA. I do think the board has a role in ensuring (I am going to use that word again) that management is following up appropriately on those MRAs and that ultimately those actions are being taken. That is an oversight role, no different than the board's normal oversight function. This is getting back to what Jewell and I were talking about earlier. The informal discussions that directors are increasingly having with our EICs is a great opportunity for directors to see whether the regulator's perspective of both progress and rate of progress. What has actually been advanced? What is the rate at which things are being advanced and is it the same as management's view? If management is telling them, "We are on track. We are doing this, we are doing that," and they drill down with any one of our examiners and say, "Well, what do you think of this?" Our examiners will give them their perspective on whether or not we think management is on track, is dealing with this in a timely manner, and getting it done properly. That is a way for the directors to validate that what management is saying is, in fact, accurate. It is another area where those informal meetings have been beneficial. If you have sixty-five, on average, MRAs and it ranges from 30 to 260 in our organizations, and you have got 200 MRAs, we are going to tell you, here are the ones we think are most important. These are the ones that have the greatest amount of urgency to them, so that the directors or committees can focus on ensuring that management is doing what it said it would do relative to those items. I do think that the board has that oversight role, but it is really management's responsibility to get this done, not the board's.

Bush: And Ollie, is that another issue that has some propensity to be a calibrated message from Washington, but perhaps with some divergence in the field?

Ireland: I think so.

Broome: Ollie, in June, Governor Tarullo posed a question about whether the fiduciary duties of the directors of regulated financial institutions should in some way be affirmatively changed to reflect regulatory objectives, like financial stability.[11] Do you have any view on whether we could or should expect to see any change like that in the future?

Ireland: I read that as floating an idea at the end of a speech that among other things criticized the Board's own guidance on dealing with MRAs. I do not see how you can go in that direction, especially when you talk about financial stability issues. There is a lot of debate about the root causes, the problems that lead to the financial crisis. Different people have different views about how it might have been averted. I think trying to require the individual board to go beyond what is good business for the bank is asking them to take on a job that they are not well equipped to do and also it puts them potentially in conflicts that are going to be hard to address. I really do not expect supervisory expectations to evolve in that direction over time.

IV. ABILITY TO RECRUIT AND RETAIN DIRECTORS

Broome: We have heard a lot about the time that is involved in being a director and the heightened standards that directors now need to be paying attention to. How are we going to be able to recruit and retain directors in this new environment? If a good friend came and asked you for your advice about whether to go on the board of one of the globally significant financial institutions, a super regional bank, or a community bank, what would you say to each of those questions?

Ireland: I always say "No. Do not do that." My personal view is that the personal risk may get greater as you go down the scale

11. Tarullo, *supra* note 6, at 10.

because the potential that the bank actually gets closed and somebody goes after the directors is higher in those cases than perhaps in a larger institution. But, I think the downside risks exceed the benefits that the individual would achieve.

Broome: Mike?

Helfer: I do not have any good friends who have the time and the expertise to do this, so it would be easy for me. If I did, the right lawyer answer is "No, no, no," for the reasons that Ollie identified. I also strongly agree with Ollie that the risks get greater as you go down in size. Part of the reason is the likelihood of failure as a statistical matter and not because I think any institution is, or should be, too big to fail. Part of the reason is that the larger institutions have more capability of finding and paying and putting to work the kinds of support and expertise that are needed to comply with all of the expectations and requirements. I think that can get to be very hard in a community bank. In addition, the community banks are often very geographically focused, thereby increasing their risks. On the other hand, despite all the lawyer predictions that we will never be able to find anybody to go on boards, at least so far, I have not seen any dramatic curtailing of willingness to serve. I have been in situations where individuals have been approached and said, "You have got to be kidding," but I have never been in a situation in which it was not possible to find a qualified person.

Bush: Jewell, since you obviously did decide to go on a board, and maybe did not ask Mike and Ollie for advice, do you think your experience as a bank supervisor made you more confident about going on a board or did you think hard about it?

Hoover: Yes to all of the above. Before I went on the Fifth Third board I was on the board of a small regional bank with about $4 billion in assets. I did think hard about it, but the answer was easier for me because as a regulator I probably understood the banking industry a little better. I was at the OCC for almost thirty years and probably interacted with 1,500 bank boards of directors during that time period about corporate governance on some level. I enjoyed the work. I enjoyed the discussion, the problem solving, and the collegial atmosphere. Collegial may seem like an oxymoron when it comes to bank regulators and bankers, but there is a lot of that collegiality in terms of the discussion. Going on a bank board had some of the same things that I enjoy and for me it was a natural extension of my skill set. I did understand the risk, but I also understood how to control those risks and how those discussions and questions and challenges should take place in the boardroom. Going on a bank board is a personal decision for each person. The reasons are very unique for each person, so they have to evaluate the opportunity and risks in that context.

Bush: I guess I have to ask, Marty, whether it surprises you or troubles you that the conventional wisdom for a lawyer to give, if asked, would be do not do it?

Pfinsgraff: It does not surprise me. We would be very concerned if we started to see a diminution in the quality of directors that are going on to boards, particularly at our largest institutions. We have not yet sensed that is a problem, but that is not to say that it could not become one. I am not surprised, however, by a lawyer making the recommendation not to join a bank board.

V. EXPECTATIONS FOR THE HOLDING COMPANY BOARD AND THE BANK BOARD

Bush: Mike, on boards where there is a high degree of overlap or overlap entirely between the holding company and the bank board, are there particular pitfalls or things to think about as a director or one advising directors in that role?

Helfer: In principle, the one thing you do not want to be is the only independent member of a bank board who is not also on the holding company board, because I think that is going to focus a huge amount of attention on that particular person as being the one who has to stand up to management and stand up to the holding company board. In my experience, this is not a current problem. It is more of a potential issue that needs to be thought about. You can imagine situations in which there is tension or even potential conflicts between what the holding company wants to do and what the bank, as a separate legal entity, views as being in its best interest, either in terms of transactions or in terms of the level of dividends and cash flow to the parent and the like. Those issues can arise within a framework where either decision is legal. Nobody is asking anybody to violate the dividend restrictions, but the question is how much you ought to do. Or, the transaction is legal for the bank, but not thought to be prudent, even though for the institution as a whole it has enormous benefits. I think as we move down the pike, you have the heightened expectations as we have been discussing applicable at the bank level, but not formally applicable at the holding company level. I think you have most boards of large regional holding companies, that I am familiar with at least, in which there is almost complete, if not complete, overlap between the holding company board and the bank board. When the OCC says you have to have "independent" directors on the bank board that means independent of management. It does not mean independent of the institution or independent of the holding company. I would not advise anybody to make any changes in process or procedure or change the paradigm right now, but I do think that directors and their lawyers need to be sensitive to the possibility of tensions coming up.

Bush: Marty, since there is some variation -- especially if you bring in community banks in either degree of overlap or some holding companies may have two charters -- are there, beyond what is written in the heightened standards, preferred models from a supervisory perspective that you think work better?

Pfinsgraff: I know that there are. I have been asked that question when we have once or twice intervened. No, we do not have guidelines on best practices. I do not think that you want us to write them. That would not be in anyone's best interest. We know when something is not working. Ultimately, we are looking to ensure that there is independence. We would then expect to see greater challenge, particularly if you have a situation where you may have an extraordinarily dominant CEO or chairman-CEO. So we want to see that independence. We do not have a best practices model, but independence would enhance oversight. In our heightened standards we basically said we need to see at least two independent directors on the bank board. But we have seen varying models. As Mike said, a lot of them are identical holding company and bank boards. So you have got a very strong independent representation. We have some where it is management, head of the risk committee, head of the audit committee, and chair of the governance committee from the holding company board who would be sitting on the bank board. We do not have a perspective on best practice. We rarely intervene, but when we do it is only when we think that something is dysfunctional or not working properly.

VI. AUDIENCE QUESTIONS

Audience Member: Marty, the first traditional responsibility of the board you listed was for the board to hire the CEO. So, the CEO is accountable to the board, ultimately management is accountable to the board, and the board will hold management accountable. How would it play out in management holding the board accountable to these higher expectations? I am not talking about things that management can do to help the board be successful, such as training. If the board or individual board members over time are not meeting their obligations under these heightened expectations, what is the supervisory expectation of management, if any, to correct it?

Pfinsgraff: Great question. Certainly, we do evaluate, and we have at times gone in and given counsel that we need to see a change on the board. In the same ways we have informal meetings with directors, we do to a greater degree have formal and informal meetings with management and others. I would hope there would be an opportunity to provide that kind of feedback in those informal meetings so that if you have dysfunction in the board, you could use us as a foil. It works both ways. Directors can raise issues around management and bounce them off of us and say, "What do you think of the CEO and how is he doing?" And we give our candid assessment. I think it is fair game that it works the other way around too.

Audience Member: In real life scandals since the financial crisis -- the LIBOR manipulation, the FX manipulation -- can you speak to the role of the board? Can a board prevent something like this? Can a board know about something that nobody knows about? Once these things happen, do regulators, or anyone who investigates these wrongdoings, go back to the board and look at what it did or did not do to discover these issues?

Pfinsgraff: The examples you raised are ones where there was collusion and fraud. It is extraordinarily difficult for managements to identify that ex-ante. It is extraordinarily difficult for regulators to identify it and so certainly we would not hold a board accountable. To the extent that you see a recurring pattern of collusion and fraud taking place within your organization, the response of regulators has been that we are calling into question the controls that you have in place and risk management that you have in place to be able to monitor and detect. When you see this issue in one area, normally our initial reaction would be, "Have you checked all of these other areas at the same time that have similar circumstances or are similarly situated where such collusion could take place?" We would not sit here and whack the board in some way.

In some cases, we have not necessarily gone and taken an action against senior management, other than we have typically called out weaknesses in control structures. It does raise a question about training, hiring, and obviously monitoring. This is where the board does have a role in making certain that appropriate actions are taken against those individuals that hold them accountable when you have had this kind of behavior. In the past, that would have been done in perhaps a less public way. Today, we are seeing organizations starting to take action in a more public way. In one situation where individuals were not involved directly in a problem, but they failed to report it, the organization will be challenged on any action they take on the individuals. They believe they will very likely lose that in court, but they are still taking that action in order to send a very strong signal to that organization that these are our values and we mean it. Where we see that, we applaud it. We think that is the right role of the board to say we are going to support management in taking an action against those individuals that knowingly violated law, violated the company's own standards and practices, and colluded or committed fraud in which to do that. In the past, companies would have taken a soft landing to not invite lawsuits. I am seeing a change in behavior and to actually deal with the cultural issues is probably appropriate.

Helfer: I think that is exactly right. That is happening. It is not easy for the board to do. But, one of the reasons it is important for the company to do it is that one would hope that this will encourage quicker escalation of issues in the future. The goal is to send the message that we are serious, that we want to know about these things. There likely were a lot of people who knew what was going on, not all of whom were directly involved in formulating the fraud or benefitting from it. You want to create an atmosphere in which those other people will find a way to escalate the issue so that something will be done about it as quickly as possible.

Broome: Many thanks to The Clearing House, to the wonderful panelist, and the audience for its engagement in the discussion on the important issues relating to heightened standards for bank directors.