CSBS SINCE 1902
CONFERENCE OF STATE BANK SUPERVISORS

February 15, 2017

Ann E. Misback
Secretary
Board of Governors of the Federal Reserve System
20th Street and Constitution Avenue NW
Washington, DC 20551
Docket No. OP-1570
Document No. 2017-16735

Dear Ms. Misback,

The Conference of State Bank Supervisors ("CSBS")[1] appreciates the opportunity to comment on the Federal Reserve Board's ("Board") *Proposed Guidance on Supervisory Expectations for Boards of Directors*.[2] State banking departments charter more than 78% of the nation's banks. Among the 4,496 FDIC insured state-chartered banks in operation as of Q3 2017, 822 are state-member banks. Shared supervisory responsibilities for these institutions necessitates close coordination and collaboration between state and federal reserve examiners.

State regulators are supportive of the Board's effort to clarify supervisory expectations of boards of directors ("BOD") at financial institutions. Specifically, state regulators support Part I of the proposal, which would create new supervisory guidance addressing BOD effectiveness for the largest financial institutions, and Part II, which would eliminate or revise redundant, outdated, or irrelevant supervisory guidance found in 27 separate SR letters. State regulators believe that the consolidation of the more than 170 supervisory expectations found in these SR letters will result in meaningful burden reduction for bank holding companies, thrift holding companies, and state-member banks, and promote a more efficient and effective supervisory process. Bringing enhanced clarity to the delineation between day-to-day responsibilities of a bank's BOD and senior management will allow BOD to focus on its core responsibilities, which include setting the firm's strategy and risk tolerance, holding senior management accountable for effective risk management and compliance, supporting the stature and independence of the firm's risk management and internal audit functions, and adopting effective governance practices.

While state regulators are supportive of the removal of duplicative guidance, we believe that additional

[1] CSBS is the nationwide organization of banking regulators from all 50 states, the District of Columbia, Guam, Puerto Rico, and U.S. Virgin Islands. The mission of CSBS is to support the leadership role of state banking supervisors in advancing the state banking system and state financial regulation, benefiting the public by ensuring safety and soundness, promoting economic growth and consumer protection, and fostering innovative state regulation and supervision of the financial services industry.
[2] 82 Fed. Reg. 37219 (proposed Aug. 9, 2017)

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clarity is needed regarding the proposed changes to the communication of examination findings (Part III of the proposed guidance).

Proposed Revisions to SR Letter 13-13/CA 13-10, "Supervisory Considerations for the Communication of Supervisory Findings"

Part III of the Board's proposal would amend SR letter 13-13 to clarify how certain supervisory findings will be communicated to an institution's BOD and senior management. SR Letter 13-13, which applies to all Federal Reserve supervised institutions, currently stipulates that Matters Requiring Immediate Attention (MRIAs) and Matters Requiring Attention (MRAs) will be directed to a bank's BOD. The letter lays out a standard process and language for communicating these exam matters in a way intended to ensure BODs are aware of key supervisory findings.

In the proposed guidance, the Board notes that the current approach has led BOD to believe that they should become directly involved in addressing the MRIAs or MRAs. The proposed guidance would amend SR letter 13-13 to indicate that Federal Reserve examiners will direct most MRIAs and MRAs to senior management, rather than the BOD, for corrective action. The text of the proposed guidance notes that this change will be effective for *all* Federal Reserve supervised institutions. The Board will continue to direct MRIAs and MRAs to the BOD *only* when they are directly related to the BOD corporate governance responsibilities or when senior management fails to take remedial action to address previous supervisory findings. The guidance indicates that "boards of directors would remain responsible for holding senior management accountable for remediating supervisory findings."

State regulators believe the amended language would benefit from additional clarity regarding the decision-making process used to determine where supervisory findings will be directed. This recommendation is described in more detail below.

Proposed Revisions to SR 13-13 Would Benefit From Additional Clarity

The Board notes that its proposed revisions to SR 13-13 are intended to reduce confusion regarding who is responsible for remediating supervisory findings. If finalized as proposed, state regulators are concerned that confusion within a bank could remain because the delineation between which matters are to be directed to senior management and which will continue to be directed to a bank's BOD is not clearly defined.

As noted above, the proposed guidance states that MRIAs or MRAs will only be directed to the BOD for corrective action when the BOD needs to address its corporate governance responsibilities or when senior management fails to take appropriate remedial action. It also notes that the BOD will remain responsible for holding senior management accountable for remediating supervisory findings. State regulators believe that confusion could emanate from the proposed guidance's use of the word "direct". State regulators want to ensure that the direction of key supervisory findings to senior management will not preclude a bank's BOD from being aware of the required actions. If directing findings to senior management means that the BOD will not be informed of the required actions, this would limit the BOD's ability to effectively perform its oversight role. The provision of clear examples that illustrate the process described in the guidance would be beneficial to supervised institutions, federal reserve examiners and state regulators.

The Board has indicated that Part III of the proposal will apply to *all* institutions supervised by the Federal Reserve, regardless of size. Additional information regarding the Board's multi-year review of the practices of bank BOD would be beneficial in order to identify whether the current process for communicating supervisory findings has posed difficulties for banks of all sizes, or only a particular segment of the industry. State regulators understand that large institutions often have a significant number of MRIAs/MRAs resulting from multiple target examinations conducted as part of the continuous supervision process. Relieving the BOD of large institutions from having to focus on the minutia of these findings makes sense, as long as BODs continue to be informed of required actions. State regulators expect that the current method for communicating exam findings may not be as onerous for smaller institutions where the volume of significant matters that require attention is typically less. Therefore, state regulators request that the Federal Reserve further explain the input that led to the decision to apply the guidance to *all* banks supervised by the FRB, and consider a bank's size and business activities in determining the process for the communication of supervisory findings.

In addition, we feel that the proposed guidance fails to consider a key issue—the inconsistent approaches taken by federal agencies in communicating exam findings. This concern is described in more detail below.

INCONSISTENT APPROACHES TO COMMUNICATION OF EXAM FINDINGS

Each federal banking agency has its own terminology for communicating important exam findings. Federal Reserve examiners issue MRIAs and MRAs within reports of examination and other supervisory communications, and *do not* include formal supervisory recommendations or observations. By comparison, FDIC examiners communicate material findings through Matters Requiring Board Attention (MRBAs).[3] According to the FDIC's Report of Examination (ROE) Instructions, deficiencies and recommendations that management can address in the normal course of business are included within the Exam Conclusions and Comments, Risk Management Assessment, and/or other supporting pages.[4]

The proposed changes to FR SR 13-13 do not attempt to harmonize between the agencies the terminology used to communicate important examination findings. State regulators encourage consistency in the supervision of financial institutions. State examiners jointly examine banks with both the Federal Reserve and FDIC. For the benefit of the supervised institution and its senior management and BOD, state examiners generally adopt the terminology used by the federal regulator on a joint exam. To increase consistency and ensure that banks understand who is responsible for taking corrective action in response to supervisory findings, state regulators encourage the Federal Reserve to work with the FDIC and States to achieve uniformity in the language and process for communicating key

[3] Statement of FDIC Board of Directors on the Development and Communication of Supervisory Recommendations. Last Updated: 07/28/2016.
[4] FDIC Report of Examination Instructions. Section 16.1.

supervisory matters. State regulators believe that the FFIEC is the best venue for working toward a uniform approach.

Current guidance from both the FDIC and Federal Reserve instructs examiners to direct most supervisory findings to a bank's BOD. Most state-chartered institutions are supervised jointly with the FDIC, which has a long history of directing supervisory findings to a bank's BOD. While supervisory matters requiring action may be more appropriately directed to bank management rather than the BOD, as contemplated by the proposed guidance, we believe that it is critical that the BOD is aware of the findings and recommendations so it can hold management accountable. Further clarification on the way that supervisory expectations directed to management are communicated to the BOD is warranted.

INTERAGENCY APPROACH TO COMMUNICATION OF EXAM FINDINGS IS NECESSARY

As a formal interagency body "empowered to prescribe uniform principles, standards, and report forms to promote uniformity in the supervision of financial institutions" the FFIEC has a long history of developing consistent examination processes on an interagency basis. Achieving uniformity in the communication of exam findings, including to whom required actions are directed and the nomenclature used to do so, falls squarely within purpose of the FFIEC. It is important to note that uniform nomenclature and examiner guidance would not prevent examiners from performing individual analyses and exercising discretion in the communication process. At a minimum, achieving a consistent approach between the Federal Reserve and FDIC process would promote uniformity in the supervision of all state-chartered institutions.

CONCLUSION

CSBS appreciates the opportunity to comment on the Federal Reserve Board's proposed guidance that would clarify supervisory expectations for bank BOD. State banking regulators support efforts to reduce unnecessary burden for financial institutions by streamlining guidance and supervisory expectations, and believe that the proposed consolidation of supervisory expectations will enable members of bank BOD to focus on their core responsibilities. While we support this component of the proposed guidance, we believe that additional clarity regarding the communication of exam findings would be beneficial to supervised institutions, federal reserve examiners and state regulators. We also believe that the Federal Reserve should coordinate with the FFIEC members to determine how uniformity in the communication of exam findings and supervisory expectations can be achieved. A uniform approach to the communication of key findings would harmonize how the various regulatory agencies present supervisory findings and ensure that significant matters are understood by a bank's board *and* senior management. We look forward to continued engagement with the Federal Reserve as it continues to explore how the communication of supervisory expectations impact regulated institutions.

Sincerely,

John W. Ryan
President & CEO