

Corporate Governance: Assessing Board Effectiveness and Culture

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Agenda

- ❑ Ratings Assessment Systems Over Time in the US
 - CAMELS; BOPEC; RFI; LFI
- ❑ Global Basel: Overview of Principles Governing Corporate Governance (BCBS)
 - Define corporate governance.
 - Identify and understand the players in corporate governance, including the lines of defense
- ❑ 2008 and Understand the Role of Regulators/Bank Supervisors
- ❑ Board Effectiveness (BE) Proposed Guidance
- ❑ Implementation
- ❑ Closing Thoughts & Questions

Disclaimer: These are the view of the presenter and do not represent the views of the Federal Reserve System or the Federal Reserve Bank of Richmond.

Ratings Systems Over Time

□ Ratings System in US a Review

- CAMELS and the “M” Management Rating
- BOPEC for Holding Companies
- RFI (First Direct Rating of Risk Management)
- LFI system for Large Holding Companies in US
 - Capital
 - Liquidity
 - Governance and Controls (G&C)

BCBS Principle 14: Essential Criteria

The Bank Supervisor:

1. Provides guidance to banks on expectations for sound corporate governance (FRS does this through SR Letters)
2. Assesses corporate governance policies/processes to determine that they are robust and commensurate with risk profile.
3. Determines processes for nominating and appointing Board members are appropriate. Board membership includes non-executive members.
4. Has the power to require changes in the composition of the bank's Board if it believes that any individuals are not fulfilling their duties.
5. Board members are suitably qualified, effective and exercise their fiduciary responsibilities.

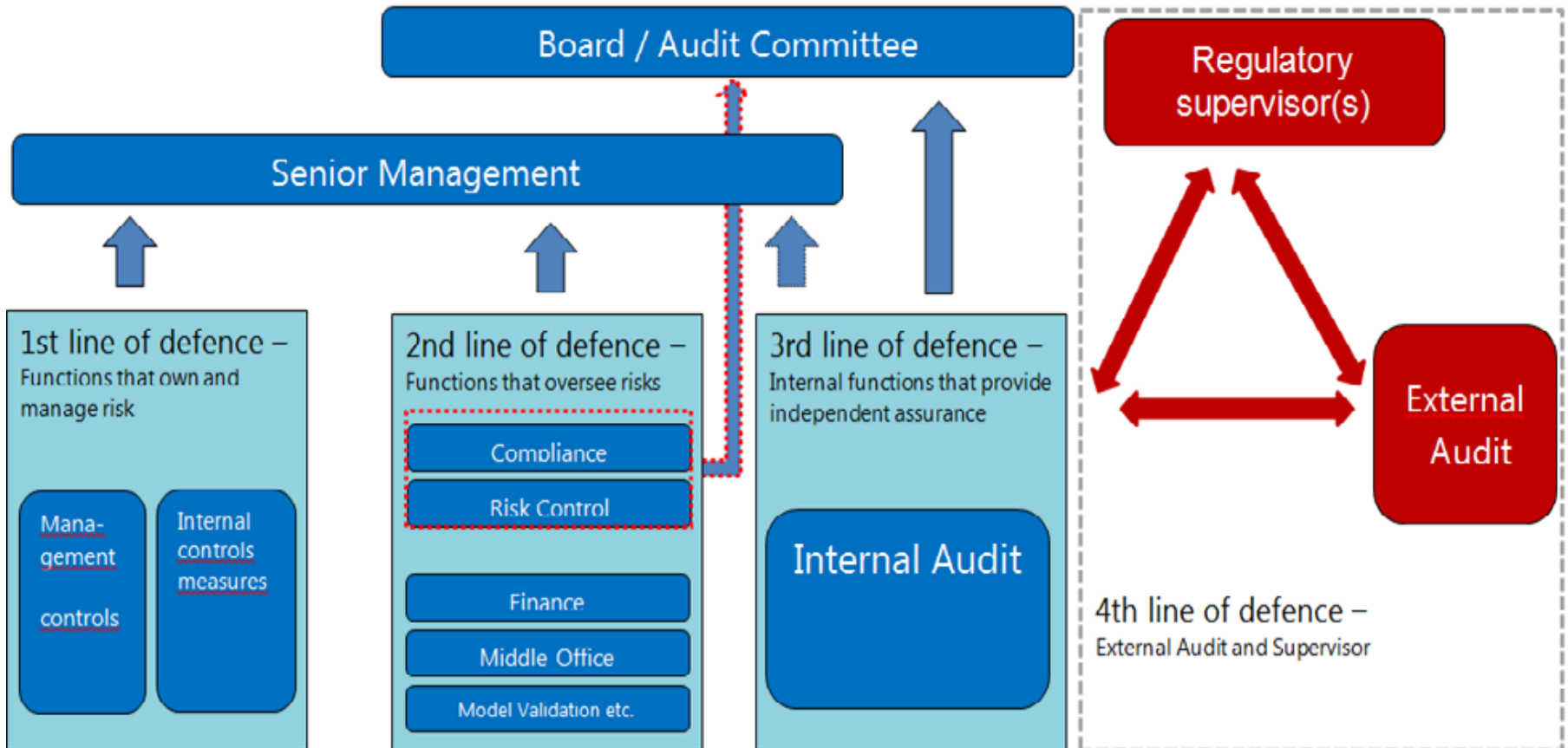
BCBS Principle 14: Essential Criteria (Cont'd)

6. Bank's Board approves/oversees implementation of the bank's strategy, risk appetite, strategy, establishes and strong control environment.
7. Bank's Board has standards for selecting senior management, succession planning, and oversees senior management's execution of Board strategies
8. Board oversees the design of the bank's compensation system (has appropriate incentives which are aligned with prudent risk taking).
9. Bank's Board and senior management understand the banking group's operational structure and its risks, including those that impede transparency (eg special-purpose or related structures).

What is Corporate Governance?

- ❑ Corporate governance refers broadly to the rules, processes, or laws by which businesses are operated, regulated, and controlled.
- ❑ Can refer to internal factors defined by the officers, stockholders or the constitution of a corporation, as well as to external forces (ie., consumer groups, clients, and government regulations)
- ❑ System of Checks and Balances

Appropriate Checks and Balances



Source: "The Four Lines of Defense Model for Financial Institutions." FSI Paper. December 23, 2015.

Board of Directors Oversight

- ❑ Approve and oversee bank's strategic objectives and ensure communicated throughout the organization
- ❑ Set and enforce clear lines of responsibility and accountability throughout the organization
- ❑ Oversee the 3 Lines of Defense
 - Ensure appropriate oversight by senior management
 - Ensure adequate resources are available to management
- ❑ Provide effective challenge
- ❑ Establish a risk appetite statement (RAS)

Board Effectiveness Proposed Guidance

❑ Guidance on Supervisory Expectations for Board of Directors

- In August 2017, the Federal Reserve issued [proposed guidance](#) in large part to **clarify the different roles of directors and senior management**.
 - Down to 5 attributes from 27 SR Letters with 170 expectations.

❑ It describes the attributes of effective boards as:

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** and **internal audit**, and
5. maintain a capable **board composition** and **governance structure**.

❑ Current Examination Activities and Historical Examples



Closing Thoughts & Questions