

## Building a high-impact, effective board<sup>1</sup>

A central theme in the public discourse on the causes of the financial crisis has been the degree to which financial institution (FI) boards were willing or able to provide a strong check on management. Many policymakers and investors have concluded boards had fallen short in this regard in the lead up to, and during, the crisis.

For their part, bank directors<sup>2</sup> attending the Financial Institution Directors Summit,<sup>3</sup> were united in their conviction that effective, high-performing boards make an important difference to the performance of their organizations. They also accepted responsibility, alongside management, for the relative performance of their bank through the crisis and going forward.

However, summit participants largely rejected broad-gauged criticism that bank directors were asleep at the switch, bank governance was lax, or board members were overly subservient to dominant CEOs. Instead, they focused on identifying critical factors for building higher-impact, more effective boards. In this context, summit participants wholeheartedly endorsed the view of Sir David Walker, in his *Review of corporate governance in UK banks*,<sup>4</sup> that:

Good corporate governance overall depends critically on the abilities and experience of individuals and the effectiveness of their collaboration in the enterprise and, despite the need for hard rules in some areas, will not be assured by box-ticking conformity with specific prescription ... [P]rincipal deficiencies in BOFI [bank or other financial institution] boards related much more to patterns of behaviour than to organisation.

This *ViewPoints*<sup>5</sup> outlines the critical success factors for building highly effective boards, as highlighted in summit discussions and in an extensive body of research developed in summit preparations.<sup>6</sup> See “About this document” (page 14) for more on the research and “FI Directors Summit participants” for a list of attendees.

- **Forging a relationship with management in which constructive challenge is both expected and respected** (*Page 2*)

Critics of FI boards have stressed the importance of the board’s providing management with more constructive challenge; they say that in the absence of that challenge, CEOs have not been held to account by boards. Summit participants and guests accept the need for a challenging, supportive, and respectful relationship with management.

- **Developing robust interactions between directors and management** (*Page 4*)

All agreed that the CEO’s attitude toward the board materially affects board effectiveness, as does the CEO’s relationship with the independent board leader. The quality and frequency of interactions between board members and a broad swath of executives is also important.

- **Getting the right set of experiences in the boardroom** (*Page 7*)

Summit participants acknowledged the value of appointing functional and sector experts to the board, but emphasized the merits of diversity and broad, senior-level leadership expertise. They described factors that complicate changes to board composition, such as loss of institutional knowledge, and the elements required to execute such changes successfully.

- **Ensuring directors have access to critical information from inside and outside the firm** (*Page 10*)

Participants believe directors should demand higher-quality information from management and should be more proactive in seeking out independent advice. Insights from regulators, shareholders, and others can be highly beneficial.

- **Respecting the line between management and board oversight** (*Page 13*)

In the end, while recognizing the need to improve board performance, summit participants highlighted the need to avoid getting too heavily drawn into decision making, becoming overly bureaucratic, and blurring the lines of accountability.

## **Forging a relationship with management in which constructive challenge is both expected and respected**

In the view of critics of FI boards, in the months and years prior to the financial crisis, boards failed to provide a sufficient check on management. Speaking prior to the summit, one research participant said, “Some awfully cozy relationships existed in boardrooms, and coziness doesn’t provide the right environment for challenge, constructive criticism, and tough questions – things that make management straighten up in their chairs and feel a little uncomfortable.” At the summit, Sally Dewar, the managing director for risk at the UK’s Financial Services Authority (FSA), expressed this concern directly: *“We observed a passive relationship between executives and non-executives. Shareholder engagement was low, and leadership was quite cavalier ... There were dominant CEOs who couldn’t be challenged.”*

As a result of this critique, many research participants interviewed before the summit said they expect board members will now be more aggressive in their line of questioning. One participant cautioned that “[directors] should not get seduced by management; they should push back, if they need to ... [They] should object to management’s proposals or new products if they don’t understand.” One director commented, “We should not be put off when you get an answer that’s not on point or when someone is being aggressive in stopping you.” Several participants outlined techniques their boards use to challenge management. See [“Techniques for constructive challenge” on page 3.](#)

However, it is not easy to establish more critical board oversight of management. Hector Sants, the FSA’s CEO, noted, “We need ... to create a culture of challenge without creating conflict. We do not want to set up [non-executive directors] as a competing governance mechanism against the executive. It is more about making both much more effective.”<sup>7</sup>

Summit participants agreed that it is difficult to characterize the optimal relationship. Noted one summit participant, *“Collegiality is fine if you are having a drink, but collegiality doesn’t work in a boardroom; it can be dangerous. It’s possible to be respectful of each other’s opinions, but if you disagree, you can do so.”* Several others agreed: *“There’s a difference between collegiality and respect. Board members need to step up to the responsibility for the organization,”* noted one. *“Collegiality ... often gets confused with trust. Trust is more important: working together towards a common goal.”*

#### Techniques for constructive challenge

- **Executive sessions.** *“The executive session provides the best opportunity to bring out a view that is at variance with the rest of the group,”* noted a group of large-company lead directors recently.<sup>8</sup> Summit participants noted that their boards have experimented with such sessions; several have significantly expanded the amount of time allotted to them or have held sessions at the beginning and end of board meetings.
- **Informal workshops.** One summit participant noted that *“it is important that you structure the time to work properly ... One thing we’ve found helpful is holding workshops with the board on individual topics. We dive down into various topics.”*
- **Early discussion.** One way to encourage debate is to have management brief the board on ideas as early as possible and to seek input *“before management has gone so far that boards can’t say no or [directors] are so conditioned that they inevitably say yes.”*<sup>9</sup>
- **Informal director debate.** One research participant highlighted a novel *“forum of dissent”* used by one of his boards. The chairman organizes a dinner with the non-executive directors for the purpose of airing contentious issues and discussing everyone’s concerns. This participant believes that it is difficult to *“raise deep points of contention cold in a board meeting”* and said that the informal dinners provide the necessary background to place issues on the board agenda for serious debate.
- **Serial questioning.** One research participant described what his firm calls *“the power of the third question.”* Any competent executive can answer the first question. The follow-up question probes for detail on the pivotal matters. Then the third question really gets to any issue or embedded false assumption.

Summit participants differed on how much more they felt their boards should be challenging their management teams. At the end of the summit, one concluded, *“We need to raise the [level of] constructive challenge with the CEO.”* Others felt their boards already challenge their management teams sufficiently.

## Developing robust interactions between directors and management

Summit participants and guests brought to light some critical factors for creating a positive dynamic between boards and management:

- A confident, open chief executive who views the board as an asset
- A seasoned board leader who draws out non-executive director opinions and concerns
- A positive relationship between the CEO and board chairman/lead director
- Deep, broad interactions between board members and key executives

### **A confident, open chief executive who views the board as an asset**

For several summit participants, the summit's key takeaway was that *“the single largest determinant of board performance is the CEO's attitude.”* Research and summit participants alike supported the view that the CEO sets the tone for the board-management relationship. The CEO's respect – or antipathy – for the board will affect how the management team regards the board, as will the CEO's view on how best to use the board.

Before the summit, one research participant contrasted different ways in which management teams use their boards: “Does management only take things to the board for approval? Does it only take those issues it has to get approval for, and not volunteer to take other issues where it has discretion? Or does management use the board to probe their ideas and proposals?” Summit participants clearly preferred the latter approach and reacted positively to the example Credit Suisse CEO Brady Dougan gave of how he engages his board in strategy planning:

*We don't start with budgeting and numbers – we start by talking with the board about our vision and direction for three to five years out. The board does a good job of stepping back: what is the environment going to be? Then we work backward from there: how do we get more operational about what that is going to look like? ... That is key because it is easy to get bogged down in today and this week and this quarter. You have to see where you are going to be. See “Credit Suisse's approach to board governance” on pages 6–7 for more excerpts from Mr. Dougan's summit comments.*

Summit participants observed that the personal style of the CEO is especially important. Several wondered, *“Will we look at different characteristics for a FI CEO in the future?”* This question got to the heart of several raised by a research participant prior to the summit: “Does [the CEO] encourage the board to engage? Does [the CEO] see they have a legitimate right to engage? Can the board have a proper discussion, weighing the arguments for and against? Can decisions actually get made at the board level?”

### **A seasoned board leader who draws out non-executive director opinions and concerns**

It is difficult to discuss the board-management relationship without addressing the question of whether the titles of CEO and chairman should be separated or held by one person. There is a heated debate among the summit participants on this topic, with US board members generally in

favor of combining the roles and the rest in favor of splitting them. Investors interviewed prior to the summit were of the opinion that this is the next big issue boards will have to address, and US policymakers are considering a number of options.<sup>10</sup>

One thing, however, is clear: the independent board leader, whatever that individual's title may be, has become more important and now has to play an even more active role in encouraging constructive challenge. In the words of one director, speaking before the summit, the independent board leader must ensure that "every voice is heard, everyone is respectful of one another's opinions, probing questions are asked, and there is significant time spent in executive session." The Walker Report stated, "Clear responsibility should be laid, and be understood to be laid, on the chairman to promote an atmosphere in which different views, within the ambit of convergent views on core long-run objectives, are seen as constructive and encouraged."<sup>11</sup> Several research participants commented prior to the summit that controlling the board's agenda-setting process is one of the chairman or lead director's essential responsibilities.

### **A positive relationship between the CEO and board chairman/lead director**

To be effective, the CEO and board chairman (or lead director) have to work well together. As one research participant put it prior to the summit, "[The chairman] has to have a close relationship with the CEO, needs to understand how the CEO makes decisions, how [the CEO] thinks, how [the CEO] presides over strategy meetings, and [the CEO's perspective on] how to make decisions with the board." Inevitably, this means spending a fair amount of time together and ongoing and frequent communications.

However, prior to the summit, one research participant cautioned that an overly cozy relationship can stifle conversation and lead to poor decisions. Another participant expressed a similar view: "CEOs with the connivance of the chairman will always get their way."

### **Deep, broad interactions between board members and key executives**

The critical importance of broad, ongoing, and frequent interactions between directors and executives – well beyond the CEO and his or her direct reports – was a major theme throughout Tapestry Networks' research leading up to the summit. During the summit discussion, the issue of making sure non-executive directors have free access to management outside the boardroom setting came up a number of times. Participants talked about "*finding the executives in the organization who can see around corners,*" "*walking the corridors,*" and visiting operations away from the firm's headquarters.

In discussions prior to the summit, it was apparent that a key factor in this regard is the degree to which the CEO tries to control interactions between directors and executives. One participant commented, "*I was surprised to hear some stories about banks during the crisis, where some of the management teams didn't know their board very well.*" Some CEOs do not concern themselves very much with such communications. Indeed, one research participant said in an earlier conversation that in his organization, non-executive directors are encouraged to "ask whatever they want." Another said of his CEO, "He not only allows, but encourages, a director to follow up with management." However, some CEOs hesitate to allow uncontrolled interactions of this

kind. One executive admitted that while his firm's directors have free access to management, "[the CEO] would want to know the purpose [of any such interaction] and [would want to] be convinced that it was not just meddling."

#### **Credit Suisse's approach to board governance**

- **Working effectively together.** *"The importance of board and management working together will increase ... Going forward, it will not be a luxury; it will be critical, due to the velocity of change and the fact that the challenges that boards have to deal with have increased dramatically. There is a whole new level of issues, and for management to deal with them on our own is just not feasible. [Management] needs to leverage the expertise, insights, and talent of the board."*
- **Supportive and challenging relationship.** *"Getting the balance of questioning, challenge, and support for management right is very important. Our board has challenged us on a lot of issues, but it is supportive ... The board can't see their involvement as only being a check on management; they need to offer solutions, not just criticism. Management needs to see the board's involvement not as interference, but as constructive." "We need to have a partnership between the entire management team – not just the CEO – and the board."*
- **Independent board leadership.** *"I am a big believer in the split chairman-CEO model. When the CEO-chairman relationship doesn't work, it can be a problem, but it provides a good balance and a new perspective on issues. Independent chairs are a valuable source of guidance for CEOs."*
- **Balance of experience in the boardroom.** *"You have to have the right balance on the board. You need expertise in the right areas, but you also need diversity. It is good to have people who are not involved in finance, to get new perspective from areas like manufacturing, branding, and marketing. It really adds valuable perspective. Plus, you have to ensure the board remains independent."*
- **Ongoing board-management interactions.** *"We spend quite a bit of time on ... exposing people on the management team to the board, formally and informally:"*
  - **Board meetings:** *"Having the full management group in the entire board meeting is important." Typically, this includes "a full day with the whole management team where we cover more general issues and topics. We then do a day on targeted issues with subsets of management." Like many other CEOs, Mr. Dougan also meets alone with the full board.*

*continued on overleaf*

➤ **Ongoing board-management interactions. (continued)**

- **Committee meetings:** *“We make sure that we have good management representation in those meetings ... having three or four people in the meetings leads to in-depth dialogue.”*
- **Informal interactions:** *“We spend some more social, unstructured time together ... Also, I meet with board members [typically on a quarterly basis] in a less structured environment.”*

## Getting the right set of experiences in the boardroom

The composition of bank boards and their committees has been a major area of public debate and has come up routinely in our research. In our initial report, we noted that one former regulator had asserted that board composition “will have to change radically.”<sup>12</sup> At the outset of the summit, a director pushed the group to reflect on whether *“the composition of boards should change, and how should they change?”*

### A good mix of experiences

Our research prior to the summit highlighted that many policymakers and institutional investors have concluded that too few bank directors have sufficient financial services experience.<sup>13</sup> This, they reason, explains bank directors’ lack of understanding of the business and their weak oversight of management. Moreover, many research participants said FI boards need more directors with relevant functional expertise, especially in key committee chairman roles, such as audit and risk. Several participants noted the benefits of having directors with regulatory experience, given the heightened scrutiny from, and evolving relationships with, regulators.

Summit participants agreed that it is important that some board members have technical and sector expertise, but they viewed the issue of board composition more broadly. One participant noted, *“‘Skills’ is the wrong word to use – it implies a certain narrow profile. I think in terms of background, experience, and seniority.”* For many present, stature and experience were most critical. Several agreed that their boards look for *“leaders in other areas who have experience running large, complex, challenging organizations,”* and *“people that are top in their field, have a proven track record, good experience.”*

Participants also noted that it is useful to have former or current CEOs from other companies on FI boards, but several also brought up a problem that was mentioned prior to the summit, namely, that *“it will be a challenge to get CEOs going forward, because many are no longer able to join multiple boards.”* Summit participants said CEOs are valuable because they bring unique experiences to the board: *“There is value in having practical experience and in being able to see eyeball to eyeball – current CEOs can do this [as board members].”* *“[They] are used to getting stuff dumped on their laps ... [and they] tend to focus on solutions.”* If FIs want to continue to be able to appoint CEOs to their boards, then participants agreed that the CEOs *“can’t [be expected to] spend as much time in committee meetings. You have to put them on lighter duties.”*

Time is an issue for all FI board directors. Summit participants noted that bank directors have had to commit more time to their roles in the past year, with some boards meeting more than 30 times in the last 12 months. Participants were of the opinion that even when the number of board and committee meetings eventually decreases, a higher overall time commitment on the part of FI directors may now be a permanent feature of FI board governance.

However, most rejected the view of Hector Sants and others that “non-executive directors ... will need to become more like full-time ‘Independent Directors.’”<sup>14</sup> Nor did they accept the idea, suggested prior to the summit, that a board or committee chair should commit between two to four days a week to board obligations. As one participant put it, *“If a director is spending three or four days a week in their board role, it is hard to see how they can maintain their independence.”* There was even some doubt about the Walker Report’s view that a typical non-executive should have “a minimum expected time commitment of 30 to 36 days [a year].”<sup>15</sup>

But even if the time commitment does not end up being as extreme as Mr. Sants and others recommend, summit participants believe that it will become increasingly hard to find and recruit new directors who are sufficiently independent and experienced and who have time available to undertake board responsibilities properly. Several research participants commented prior to the summit that the intensity of public, political, and investor criticism directed at bank board directors may make it more difficult to attract top-level talent to bank boards. For some candidates, potential personal liability and reputational damage outweigh the benefits of sitting on these boards. Participants concluded that FI boards may need to be more creative in matching different board roles and levels of commitment to the candidates they are hoping to recruit.

### **Dangers in changing FI board composition**

Summit participants discussed a number of the risks identified in pre-summit research relating the current trend toward altering FI boards:

- **“Group think.”** Prior to the summit, several research participants cautioned against overpopulating boards with too many non-executive directors from within the industry: “[There is a danger] that the non-executive directors [would be tempted to] assume a management role ... especially those with highly relevant experience,” noted one participant. Another asserted, “You [could] end up with people who are too like-minded. If they’ve all seen the same things, they’ll probably all react in the same ways.” At the summit, one participant noted that *“people who grew up in the capital markets business tend to be transactional thinkers, not strategic thinkers.”*
- **Over-reliance on experts in the boardroom.** Summit participants agreed that too many functional or sector experts on the board can be problematic. As one director put it before the meeting, having too much functional expertise on the board not only can create potential tensions with management, it can create dysfunctional boardroom behaviors: “The real danger with adding [functional] knowledge is that the board members not on those committees think, ‘The experts have that covered.’ The [committee] chairman becomes the go-to person [on a given topic.]”

- **Lost institutional memory.** Several summit participants agreed that too much director turnover can harm the board’s overall understanding of the business, particularly in times of crisis. One observed that director turnover *“can work against institutional memory. I want directors who have been through the battles. You need a set of people that are calm.”* Another noted that institutional knowledge is particularly important in banking, given that *“we seem to have a crisis every seven or eight years.”*
- **Drowning out the broader questioners.** Several research participants warned before the summit that one danger of the current changes in board composition is that directors without financial services or functional expertise may get drowned out, to the detriment of boardroom discussion. One executive encouraged those directors to speak up: *“They’re exactly the ones who should be asking for more explanation, especially if they don’t understand something. They need to participate and engage more – they can’t leave it to the ‘experts.’”*

### Challenges in changing board composition

Summit participants also discussed the challenges in changing board composition:

- **Dealing with average performers.** There was some agreement with the view that *“the real problem in board renewal is turning over people who are good, but not great, directors. Poor performers are actually easier to move out.”* One noted that *“underperformers know who they are.”* Generally, participants agreed that underperformance is *“usually not an issue of quality ... It’s not having the commitment or engagement.”*
- **Conducting effective director and board evaluations.** Increasingly, institutional investors are calling on FI boards to adopt more robust board and director evaluations and demanding that boards make their evaluation process more transparent to the market.<sup>16</sup> Regulators are seeking the same thing, as Mr. Rutledge noted at the summit: *“[We will look at ... [whether] the board has in place a process to do periodic reviews of governance structures, processes and board composition? Is the review external or internal?”* Summit participants noted that establishing robust evaluations is challenging. Only about a half of summit participants said their boards conduct director-level evaluations. Several participants outlined the manner in which they conduct evaluations of their board. One noted, *“We do an annual survey of directors, with an in-depth review every three years – we use an external provider for that.”* This approach accords with one that has been pushed by a number of policy advisers in the UK and the Netherlands.<sup>17</sup> Another summit participant noted that after trying various alternatives, *“we asked directors to answer three essay questions. Then we held one-on-ones with directors as well as the management team. By that time, they were prepared to talk ... about whatever they didn’t want to write down. Then we did a peer review, getting everyone’s off-the-top assessments.”*
- **Having effective director succession planning.** As one participant noted, *“The [board or governance committee] chair has an extremely challenging role with succession planning – getting the right people, dealing with different roles and personalities, over long time frames.”* Summit participants noted that age or tenure limits can be objective mechanisms for

accomplishing director turnover, but some were concerned that these criteria can be arbitrary and unhelpful.

- **Having a courageous board or governance chair.** Any director who has been involved in changing the makeup of the board knows it isn't easy. As one chief executive put it before the summit, "Board membership is very hard to overhaul ... The culture of a board is very self-supportive." Few board leaders relish the prospect of counseling a director to leave the board, but a good board or governance chair has the courage for the task. Summit participants acknowledged that, ultimately, *"The most important person in that aspect is the chair of the governance committee [or board] who has enough guts to fire someone for poor performance."*
- **Managing regulators' demands to be involved in director selection.** Regulators have signaled that they want to be more actively involved in director selection, notably the FSA. At the summit, Ms. Dewar noted, *"we need to be involved earlier in the process."* Summit participants were concerned about direct regulatory involvement in board appointments, and wondered how best to factor regulators' views in, if at all.

## Ensuring directors have access to critical information from inside and outside the firm

A constant theme in our research has been the necessity of keeping non-executive directors fully informed about new developments in their firms, capital markets, and the economy at large, particularly given the degree and velocity of change in the financial services sector. Summit participants discussed a number of factors of relevance.

### Timely, comprehensive, and comprehensible information

Information flows are the lifeblood of constructive and informed dialogue, and many participants in our research suggested that non-executive directors should be more proactive about ensuring these flows are optimal. "[Boards should ensure] that they are getting the information they asked for, and in a timely manner," asserted one, speaking prior to the summit. Several participants believe that "non-executive directors should be able to define what information they require."

Mr. Dougan looked at the matter from management's perspective: *"[The] management team [has to be] willing to highlight and raise with the board the things [that could truly have an impact on the company]. It's management's job to make it digestible. There is no Rosetta Stone. We do have to get down to a level of detail."* In our research prior to the summit, executives pointed to their efforts over the last 12 to 18 months "to raise the bar on communications and transparency." However, getting the information flows right can be challenging. One research participant stated, "We spend a lot of time looking at reporting ... what's the right balance, level of detail, quantity of information. It's a real struggle to get it right."

### **Sufficient resources for the board**

Summit participants debated whether non-executive board members, particularly committee chairs, need additional resources. One participant asserted, “[*Directors*] could deal with the time and complexity challenges if we had something like a full-time secretariat, reporting to the board rather than management, for analytical and judgmental support.” Such support has been the subject of regulatory discussion. The UK House of Commons Treasury Committee stated, “There is a strong case for non-executive directors in the banking sector to have dedicated support or a secretariat to help them to carry out their responsibilities effectively.”<sup>18</sup>

However, several summit participants cautioned against establishing support functions for the board, saying that they “would invite an inevitable clash with management.” “It might also dilute accountability. Who would be responsible for the decisions the board made – the directors, or those who provided the analysis?” asked one participant. Prior to the summit, several research participants also pointed out that putting in place board support personnel might be taken as a sign that the board does not trust management.

### **Access to external perspectives, including regulators’ perspectives**

On numerous occasions during the summit discussions, participants suggested that boards should seek out more external perspectives. One participant commended progress in that direction but urged more effort: “Boards are doing more seeking out of external input to supplement their relationships with management ... [but] we can still take it a bit further.”

While management may feel uncomfortable with the idea of the board seeking out external information or perspectives, the truth is that boards already have access to some external advisers, notably the external auditor, compensation consultants, and legal counsel. Summit discussions and our pre-summit research suggest that more boards are also considering the use of external expertise on risk.<sup>19</sup>

One summit participant noted that he routinely meets with consultants steeped in the industry “to keep me informed about industry trends – sector issues and topics like risk management. I think there’s a tremendous opportunity to do more of this.” Participants also briefly discussed interactions with major shareholders, although none had seen a major uptick in such interactions. Prior to the summit, one research participant noted that “shareholders have a range of views” and suggested that “long-term investors want to come along and say, ‘This is what we think about your company or strategy; go away and think about it.’” Such insight may provide boards with a different, unfiltered perspective on critical issues.

Regulators offer a valuable external perspective. Directors are keenly aware of the need to change the tenor and frequency of their interactions with key regulators,<sup>20</sup> and summit guests and participants discussed interactions with regulators in some detail. Indeed, Ms. Dewar of the FSA and Bill Rutledge, the executive vice president of the Bank Supervision Group of the Federal Reserve of New York, both pointed out that “[*regulators*] are trying to have more interactive dialogue with non-executive directors, including one-on-one discussions.” Clearly, the regulators are using these interactions for their own purpose. As Ms. Dewar put it, “This gives us the

*opportunity to know what's going on in the boards' minds." Mr. Rutledge commented, "Do board directors come across as independent thinkers when we interact with them? When we talk to boards, it is often with committee chairs, on the kinds of things that boards are pushing management to explore ... We need to get a credible sense that the board is asking good questions of management."*

Both Ms. Dewar and Mr. Rutledge encouraged boards to use regulators as independent sources of information, an idea that had found some favor prior to the summit, when many directors supported the suggestion that "boards and regulators should strive to have open communication channels and off-cycle informal discussions with no intention of documenting the dialogue." Mr. Rutledge rued the fact that the Fed's *"interactions with directors have been much less frequent [than with management] and generally in formal sessions with limited interaction."* He encouraged boards and management teams to ask regulators, *"How do we stack up against our competition? We have a breadth of knowledge based on our access ... [and] we have done horizontal reviews where we looked across firms internationally."*

One summit participant: *"I've seen more involvement of board members with regulators. That has been very constructive, because it gives regulators another level of contact. If regulators see that boards are sufficiently engaged and challenging management appropriately, that is very helpful with some of the public perception issues."* Another participant described the now-quarterly meetings he has with his home-country regulators: *"They don't come with a report; they come with about six or seven key issues – things like their views on company leadership, or questions about stress scenarios. We found those meetings to be very productive."*

### **An effective orientation and an ongoing commitment to learning**

Several participants in our pre-summit research endorsed a stronger focus on director education, particularly at the committee level. "There needs to be an investment in ongoing education by board members," stated one director. To start, "directors need to understand how money is made in the business, what the risks are, and what the losses are attributable to." Next, "directors should ... understand what products they've got, services they offer, markets they operate in, and so on." Armed with such knowledge, "board members need to understand the firm's strategy and the implications of implementing it in the way proposed by management. Every board member needs to be capable of expressing a view about strategic issues."

At the summit, several participants pointed to the benefits of a mentoring program for new directors. One noted, *"The mentorship program at [our bank] has been very helpful. Every director is paired up with someone on the board, and there's an onboarding process. They get some targeted support, and from there it's up to the individual to decide how much to use their mentor. It really helps new directors get up and running."* Speaking about ongoing education, another participant reported, *"To help board members understand the business, we have heads of the lines of business or regions meet with us. We have the chance to ask very open questions about both the business and the people. It's helpful for [them], and very informative for us."*

The issue of director orientation and education is likely to remain on the agenda, in part because several high-profile policy groups in the UK<sup>21</sup> and the Netherlands<sup>22</sup> have called for more systematic director training and education.

## Respecting the line between management and board oversight

Summit participants discussed at some length the need for boards to be careful in not overstepping their role, given their enhanced level of oversight. They pointed out that *“regulators want boards to take responsibility not just for oversight, but for some decisions as well,”* which brings up another concern: *“Where does management stop and the board take over?”* Some participants were highly averse to putting the board or its committees in a decision-taking mode: *“We don’t make decisions; we make sure that we ask for feedback; we make sure that we challenge management,”* noted one. Others were more relaxed about the board being an active decision-making body: *“I am not afraid of having decisions taken by the board. The board says yes or no and is fed by management. The key is the board is in the second seat, responding to management’s proposals.”*

The summit discussion highlighted two practical challenges to deeper engagement:

- **Bureaucratic decision making.** With more engagement comes an increase in board activities, which means longer board and committee agendas and more frequent interaction with management and outside stakeholders, all of which could slow down decision making to a potentially dangerous degree. As one director pointed out prior to the summit, FI boards need to remain deft in their decision making: *“You need clear and timely debate, because things are on a shorter time fuse [than in non-financial institutions] ... We can need fundamental change to our products by the end of a week.”*
- **Unclear lines of accountability.** Critics note that if the board becomes embroiled in its firm’s decision-making processes, it can undermine management’s authority to lead the business day-to-day. Moreover, the board may find it more difficult to hold management accountable for their actions when the board itself is highly involved. To help address that problem, the Basel Committee on Banking Supervision recommends that *“the board and senior management ... ensure that accountability and lines of authority are clearly delineated.”*<sup>23</sup>

## Conclusion

Bank board directors are in full agreement with their critics that boards matter; they can, and should, have a material effect on their firms’ performance. They acknowledge that FI boards should be composed of members who are equipped with the skills, information, external input, and time to challenge and support management. Summit participants are focused on building higher-impact, more effective boards that act as sources of insight for management, not as merely a check on management’s activities. The concept of a new era of partnership, one built on trust, candor, and respect, appeals to summit participants. However, they recognize that FI boards need to be careful not to usurp the role of management or to weaken the necessary lines of accountability for running their firms.

## About this document

The Financial Institution Directors Summit brought together leading non-executive directors from North American and European financial institutions on October 5 and 6, 2009, to share perspectives on proposals for strengthening corporate governance. *ViewPoints* summarizes the proceedings of the summit. The peer-to-peer discussions were informed by prior interviews with over 120 FI directors, executives, regulators, investors, and other key stakeholders. Tapestry Networks conducted the research, orchestrated the summit, and prepared *ViewPoints*. Ernst & Young sponsored the research and summit as part of its deep, continuing commitment to board effectiveness and good governance.

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## Endnotes

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- <sup>1</sup> This *ViewPoints* is part of a larger report which integrates participants' discussions at the Financial Institution Directors Summit with extensive research conducted over the past year. The full report is available at [http://www.tapestrynetworks.com/documents/Tapestry\\_EY\\_BGLN\\_Nov09\\_fullreport.pdf](http://www.tapestrynetworks.com/documents/Tapestry_EY_BGLN_Nov09_fullreport.pdf).
- <sup>2</sup> In this document, "director" refers to non-executive, non-employee board members on a firm's unitary or supervisory board.
- <sup>3</sup> On October 5 and 6, 2009, 18 board members from leading European and North American financial institutions met in New York to discuss the future of bank governance. They were joined for portions of the meeting by Brady Dougan, CEO, Credit Suisse Group; Sally Dewar, Managing Director, Risk, UK Financial Services Authority; Bill Rutledge, Executive Vice President, Bank Supervision Group, Federal Reserve Bank of New York; and Jim Turley, Chairman and CEO, Ernst & Young.
- <sup>4</sup> David Walker, *A review of corporate governance in UK banks and other financial industry entities* (London: HM Treasury, 2009), 8. Available at [http://www.hm-treasury.gov.uk/d/walker\\_review\\_consultation\\_160709.pdf](http://www.hm-treasury.gov.uk/d/walker_review_consultation_160709.pdf).
- <sup>5</sup> The *ViewPoints* reflects the use of a modified version of the Chatham House Rule whereby names of members, guests, and company affiliations are a matter of public record, but comments made by members before and during meetings are not attributed to individuals or corporations. However, Messrs. Dougan and Rutledge and Ms. Dewar, who were all speaking in a personal capacity and whose views do not necessarily represent those of their organizations, have given permission for their remarks to be attributed. Comments by these guests and summit participants are shown in italics.
- <sup>6</sup> Tapestry Networks has published two briefing notes under the title *Shaping bank governance in a new era*. The first, subtitled *Enhanced oversight versus radical reform*, was published in June 2009. The second, subtitled *A revised compact with management and shareholders*, was published in August 2009. Both are available at [http://www.tapestrynetworks.com/networks/net\\_bank.html](http://www.tapestrynetworks.com/networks/net_bank.html).
- <sup>7</sup> Hector Sants, "The regulator's role in judging competence." Speech at the Securities & Investment Institute Conference, May 7, 2009. Available at [http://www.fsa.gov.uk/pages/Library/Communication/Speeches/2009/0507\\_hs.shtml](http://www.fsa.gov.uk/pages/Library/Communication/Speeches/2009/0507_hs.shtml).
- <sup>8</sup> Lead Director Network, "The board's role in risk management," *ViewPoints*, July 24, 2009, 8. Available at [http://www.tapestrynetworks.com/documents/Tapestry\\_KS\\_LDN\\_View4\\_Jul09.pdf](http://www.tapestrynetworks.com/documents/Tapestry_KS_LDN_View4_Jul09.pdf).
- <sup>9</sup> Tapestry Networks, *Shaping bank governance in a new era: A revised compact with management and shareholders* (Waltham, MA: Tapestry Networks, 2009), 11.
- <sup>10</sup> For example, the SEC has proposed mandatory disclosures on the chosen board leadership approach. See US Securities and Exchange Commission, "Proxy Disclosure and Solicitation Enhancements," proposed rule, July 10, 2009, 34. Available at <http://www.sec.gov/rules/proposed/2009/33-9052.pdf>.
- <sup>11</sup> David Walker, *A review of Corporate Governance in UK Banks and Other Financial Industry Entities*, 6, 10.
- <sup>12</sup> Tapestry Networks, *Shaping bank governance in a new era: Enhanced oversight versus radical reform* (Waltham, MA: Tapestry Networks, 2009), 11.
- <sup>13</sup> *Ibid.*
- <sup>14</sup> Hector Sants, "Delivering intensive supervision and credible deterrence." Speech at the Reuters Newsmaker event, March 12, 2009. Available at [http://www.fsa.gov.uk/pages/Library/Communication/Speeches/2009/0312\\_hs.shtml](http://www.fsa.gov.uk/pages/Library/Communication/Speeches/2009/0312_hs.shtml).
- <sup>15</sup> David Walker, *A review of corporate governance in UK banks and other financial industry entities*, 10.
- <sup>16</sup> International Corporate Governance Network, *Second Statement on the Global Financial Crisis* (London: International Corporate Governance Network, 2009), 4. Available at [http://www.icgn.org/files/icgn\\_main/pdfs/news/icgn\\_statement\\_on\\_the\\_financial\\_crisis\\_23\\_march\\_09.pdf](http://www.icgn.org/files/icgn_main/pdfs/news/icgn_statement_on_the_financial_crisis_23_march_09.pdf).
- <sup>17</sup> See section 4.27 in David Walker, *A review of corporate governance in UK banks and other financial industry entities*, 57, and Advisory Committee on the Future of Banks in the Netherlands, *Restoring trust* (Advisory Committee on the Future of Banks in the Netherlands, 2009), 13 (available at <http://www.nvb.nl/scrivo/asset.php?id=290353>).
- <sup>18</sup> Treasury Committee of the House of Commons, "Corporate governance," <http://www.publications.parliament.uk/pa/cm200809/cmselect/cmtreasy/519/51907.htm#a24>.
- <sup>19</sup> Tapestry Networks, *Risk governance in a new era* (Waltham, MA: Tapestry Networks, 2009), 16.
- <sup>20</sup> Tapestry Networks, *Shaping bank governance in a new era: Enhanced oversight versus radical reform*, 13–14.
- <sup>21</sup> David Walker, *A review of corporate governance in UK banks and other financial industry entities*, 10.
- <sup>22</sup> Advisory Committee on the Future of Banks in the Netherlands, *Restoring trust*, 13.
- <sup>23</sup> Basel Committee on Banking Supervision, *Enhancements to the Basel II framework* (Basel: Basel Committee on Banking Supervision, 2009), 13. Available at <http://www.bis.org/publ/bcbs150.pdf?noframes=1>.

## FI Directors Summit participants

### Board director participants:

- Jalynn H. Bennett, Corporate Governance Committee Chair, Audit Committee Member, CIBC
- Roy J. Bostock, Nominating and Governance Committee Member, Morgan Stanley
- Sir Richard Broadbent, Deputy Chairman, Risk Committee Chair, Corporate Governance and Nominations Committee Member, HR and Remuneration Committee Chair, Barclays
- Dr. Karl-Gerhard Eick, Audit Committee Chair, Deutsche Bank
- Laban P. Jackson, Jr., Audit Committee Chair, JPMorgan Chase
- Olivia F. Kirtley, Audit Committee Chair, Governance Committee Member, Executive Committee Member, U.S. Bancorp
- Jean Lanier, Audit Committee Member, Credit Suisse
- Nicholas D. Le Pan, Risk Management Committee Member, CIBC
- Brian M. Levitt, Risk Committee Member, TD Bank
- Donald T. Nicolaisen, Audit Committee Member, Compensation, Management Development and Succession Committee Member, Morgan Stanley
- Charles H. Noski, Audit Committee Chair, Morgan Stanley
- William G. Parrett, Audit Committee Chair, UBS
- Arthur F. Ryan, Nominations Committee Member, RBS
- Anthony M. Santomero, Audit and Risk Committee Member, Public Affairs Committee Member, Citigroup
- David Sidwell, Risk Committee Chair, Strategy Committee Member, UBS
- Patrick T. Stokes, Risk Management Committee Chair, Compensation and Human Resources Committee Member, Executive Committee Member, U.S. Bancorp
- John M. Thompson, Chairman, Corporate Governance Committee Chair, Management Resources Committee Member, TD Bank
- Anton van Rossum, Risk Committee Member, Credit Suisse

### Ernst & Young participants:

- Carmine DiSibio, Vice Chair and Managing Partner, Financial Services
- Radwan Hoteit, Leader and Market Coordinator, Banking and Capital Markets, EMEIA Financial Services
- Thomas P. McGrath, Managing Partner, EMEIA Financial Services
- Lawrence Prybylski, Global Practice Leader, Financial Services Risk Management
- William Schlich, Industry Leader, Banking and Capital Markets, Financial Services
- James S. Turley, Global CEO and Chairman
- Donald T. Vangel, Advisor, Regulatory Affairs