

Invigorating bank governance in a new era

Perspectives from the Financial Institution Directors Summit

In the wake of the global financial crisis, it is clear that some banks managed to anticipate danger and reduced their exposures to risky assets early; others largely avoided these investments from the start. Many banks, however, were holding too many troubled assets “when the music stopped” and consequently found themselves with insufficient capital and liquidity. Critics asserted that these banks’ poor strategic choices and investment decisions represented not only a failure of judgment, but also a failure of governance.

Accordingly, investors, politicians, and regulators have called for significant reform in bank governance and, for a number of financial institutions (FIs), demanded different board rosters. Stakeholders have made it clear that henceforth they will hold directors more accountable, in particular for decisions on risk and compensation.

Board members from leading global banks participating in the Financial Institution Directors Summit¹ on October 5 and 6, 2009, largely agreed that failures of governance contributed to the crisis, and reaffirmed their conviction that effective governance can make a meaningful difference in corporate performance. They acknowledged the heightened expectations placed on non-executive directors and confirmed that they are already rising to that challenge. In this environment, boards are reviewing their practices and asking themselves tough questions about opportunities to improve. See “FI Directors Summit participants” for a list of attendees.

This report weaves the perspectives and ideas about bank governance that summit participants shared in vigorous discussion over two days together with extensive research conducted over the past year.² It comprises four *ViewPoints*:

- “Restoring trust: lofty expectations for post-crisis boards” sets out the new demands placed on directors and boards, argues that restoring trust by building enduring institutions should be a board’s overarching goal, makes the case for a deeper and broader partnership between the board and management, and cautions that governance itself is at a turning point.
- “Risk governance in a new era” explores new approaches to understanding risk, determining risk appetite, setting the risk agenda, and balancing and integrating risk decisions with strategy and performance goals.

¹ 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.

² Since late 2008, Tapestry Networks has been leading an effort to support directors of leading FIs as their boards review governance practices and ask themselves tough questions about opportunities to improve, in light of intense external criticism. To date, we have spoken to over 100 board directors, current and former FI executives, regulators, investors, and other thought leaders from Europe and North America. Ernst & Young sponsored this research, and the summit, as part of its deep, continuing commitment to board effectiveness and good governance.

Bank Governance Leadership Network

- “Banker compensation at a crossroads” discusses the challenges boards face in shaping new compensation policies that conform to the new regulatory requirements and take account of public and political pressures to rein in pay.
- “Building a high-impact, effective board” addresses the issues of directors engaging with and challenging management, getting the right experiences into the boardroom, and ensuring the board has access to internal and external information – all while respecting the line between management and the board.

We encourage you pass along this report to colleagues who would benefit from these perspectives. Additional hard copies are available upon request.

Summit participants appreciated the unique opportunity to share and consider ideas in a candid, peer-to-peer format. They encouraged us to reconvene the group of directors of leading FIs in the spring of 2010, and we will be pleased to do so. In recognition of the fact that the group will likely want to meet on a continuing basis, we have started to think about it as the Bank Governance Leadership Network (BGLN) – non-executive directors and senior management dedicated, alongside other key stakeholders, to outstanding governance in support of the mission of building enduring, praiseworthy banking institutions.



William Schlich
Industry Leader, Banking and Capital Markets
Ernst & Young



Thomas M. Woodard
Partner
Tapestry Networks

November 2009

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

Restoring trust: lofty expectations for post-crisis bank boards¹

The job of the large-bank board member got a great deal more complicated, demanding, important, and visible as the global financial crisis unfolded in 2008. Expectations for directors² and their boards have never been higher. *“The lesson for us is that it is not going to get easier in the near term. This may in reality be the new steady state,”* asserted one large-bank director.

Bank directors attending the Financial Institution Directors Summit³ on October 5 and 6, 2009, stated unequivocally that the paramount expectation now placed on boards is, as one director put it, *“Restoring trust. In recent years the banking industry has lost the trust of almost all of its stakeholders. It is a challenging position to get into.”* Within this context, they all wondered, *“What is the role of the board in this?”*

This *ViewPoints*⁴ outlines the challenges facing bank boards as they work to meet and exceed the lofty expectations placed on them by the full range of players who have a stake in the success of our financial system and its institutions. It draws on summit discussions and an extensive body of research developed in preparation for the summit. See [“About this document” \(page 10\)](#) for more on the research and [“FI Directors Summit participants”](#) for a list of attendees.

In the sections that follow, we expand on five principal themes:

- **Everyone expects much more from bank boards now** (*Page 2*)

Financial institution (FI) boards are expected to fix today’s problems and prevent new ones from arising. Boards are simultaneously addressing the concerns and demands of regulators, shareholders, senior management, customers, staff, politicians, and the general public. Bank directors are fully committed to meeting the new expectations.

- **Restoring trust by building great institutions may be the most compelling single goal** (*Page 4*)

By setting the objective of building strong and enduring firms, FI leaders can both defuse and redirect the debate about the primacy of shareholders relative to other stakeholders. Great institutions provide high-quality services and build respected brands; they behave ethically; they balance safety and financial results in search of sustainable performance; they are excellent long-term employers; and they show commitment to their communities. In so doing, they serve all stakeholders’ long-term interests.

- **Key to the board’s success is its rededication to making a meaningful difference** (*Page 6*)

Mere oversight, if it was ever adequate, will no longer meet anyone’s expectations. The commitment of the board, and each director on it, must be focused and unwavering. With

these facts in mind, boards are forging a deeper, more engaged partnership with management and are increasing the frequency of their interactions with external constituents as well. They are seeing a transformation in their involvement in risk governance.

- **Breadth, depth, and relationships are required** (*Page 8*)

Board members today must have both a broad perspective and deep understanding of the details. Moreover, they must cultivate relationships with management, investor representatives, and regulators. Direct engagement with shareholders, regulators, and policymakers will likely become the norm rather than the exception.

- **Governance is at a crossroads** (*Page 9*)

No one is sure which direction governance will take, but everyone hopes that it will emerge better, stronger, and more effective. However, board members are deeply concerned that the unintended consequences of the many reform measures being imposed and now under consideration may be to destabilize and degrade corporate governance. Board leaders wish to engage constructively in the public discussions on how to improve corporate governance, but do not have a collective forum through which to do so.

Everyone expects much more from bank boards now

Lax board governance is often cited as one of the many factors that gave rise to the present financial crisis. In recent months, investors and regulators have called for significant reform in board governance, and in the case of a number of FIs, they have demanded different board rosters. Stakeholders have made it clear that they plan to hold directors more accountable for decisions on risk and on compensation structures. In this environment, boards are reviewing their practices and asking themselves tough questions about opportunities to improve.

Quite a number of thoughtful, independent, and well-researched analyses of the financial crisis are now available.⁵ As we noted in our briefing notes,⁶ these reports largely agree on causes of the crisis – macroeconomic imbalances, regulatory failure, market failure, over-leverage, procyclicality in the system, weak risk management (both systemic and micro-prudential⁷), financial product innovation, risk-inducing compensation, greed, and malfeasance.⁸

Debate on the culpability of boards

Many of these analyses include directors on the list of culpable figures, alongside members of management, regulatory authorities, politicians, credit rating agencies, and investors. In pre-summit discussions, research participants diverged on how much blame boards should shoulder:

- **Boards could have done little.** Some believe the crisis and consequent damage to firms resulted from powerful forces largely outside the control of board members and their institutions. One executive asserted, “Expectations for boards have been too high, mainly because of political pressure.” Another agreed: “We need to appreciate that there is a

fundamental mismatch between the board’s level of responsibility and its [day-to-day] authority.”

These individuals believe that while some banks fared better than others, ultimately boards could have done little to prevent the crisis. Said one summit participant, *“Individual boards can’t take responsibility for the entire system.”*

- **Boards bear significant responsibility.** Others believe boards had a clear responsibility to understand the risks in the global economy and on their own books and to take measures to protect their firms and shareholders. As one director stated at the summit, *“Lax governance did increase the likelihood and severity of the problems in the system, and as a result there was a greater impact on shareholders.”*

As the International Corporate Governance Network, a group of institutional investors with approximately \$9.5 trillion assets under management, put it, “It is now widely agreed that corporate governance failings were not the only cause of the crisis but they were highly significant, above all because boards failed to understand and manage risk and tolerated perverse incentives.”⁹ Similarly, the Senior Supervisors Group identified as a contributing factor to the crisis “the unwillingness or inability of boards of directors ... to articulate, measure, and adhere to a level of risk acceptable to the firm.”¹⁰

Boards have been accused of failing in a number of ways, notably insufficient engagement, knowledge of the business, independence, and willingness to challenge management, as we have observed previously.¹¹ One regulator said bluntly, “There is a general sense that [directors] weren’t asking the right questions or getting the right information.”¹²

Regardless of how much blame they felt boards should bear for the crisis, participants in Tapestry Networks’ research agreed that effective, high-functioning boards can have a significant positive effect on firm performance. One director suggested, “The right question is not whether boards could have stopped the crisis ... It’s whether they could have reduced the number and size of surprises. To that, one has to answer yes.” Julie Dickson, the head of the Canadian financial services regulator, expressed a similar sentiment recently, observing, “Boards can prevent the destruction of value by saying ‘no.’”¹³

The potential of boards to make a difference

Polling results at the summit indicate that board members accept a considerable amount of responsibility. Three-quarters of the group either agreed or strongly agreed with the statement “Lax board governance was one of the major contributing factors to the global financial crisis.” One director stated, *“We still would have had a global financial crisis, but it might not have been as severe [if bank governance had been better].”* Another observed, *“It’s not obvious to me that we are good enough as boards. And the rest of the world likely doesn’t think so.”* Brady Dougan, CEO of Credit Suisse, emphasized at the summit that when boards and management work together well, *“It can be very powerful. And going forward, it will not be a luxury: it will be*

critical due to the velocity of change ... We need to leverage the expertise, insights, and talent of the board.”

Restoring trust by building great institutions may be the most compelling single goal

In considering expectations for the board, the question naturally arises: whose expectations? One summit participant asked, *“How do you go about resetting expectations for the board when everyone has a different understanding of what the board is supposed to do?”*

Many of the participants in our research shared the view of one former regulator who said, “Split loyalties make things very difficult for directors, and, ultimately, firms end up sacrificing profits. The board should be accountable to shareholders and let regulators take the part of larger societal interests.”

However, the severity of the financial crisis and consequent ripple effects into the broader global economy have led some commentators and reform advocates to declare that FI boards should consider a broader range of stakeholders and not grant the shareholder primacy. The Advisory Committee on the Future of Banks in the Netherlands, for example, suggested that “a bank’s Executive Board and its members should base their actions on a balanced consideration of the interests of the savers, clients, shareholders, employees and the society in which the bank operates.”¹⁴

Some participants agree: *“Society [is a] stakeholder in FIs in a way they’re not in other industries,”* one director remarked. “Directors have an obligation to consider the public interest,” declared a regulator, arguing that since FIs benefit implicitly – and, since the crisis, in many cases explicitly – from government support, they should take that support into account. To some degree, the political debate on bank reform in the run-up to two G-20 meetings this year reflects the belief that FIs cannot be run without taking into account their unique position in economies.

One summit participant put it succinctly: *“Boards need to regain trust, while balancing social utility with shareholder value.”*

To whom is the board accountable?

In remarks to summit participants, Sally Dewar, the managing director for risk at the UK’s Financial Services Authority (FSA), noted, *“Greater engagement, especially with shareholders”* will be an aspect of director activity which regulators will be watching for in the future. Only two out of 15 respondents polled at the summit disagreed with the statement “Bank boards should remain predominantly accountable to shareholders.” Seven agreed and six strongly agreed with this affirmation of the importance of shareholders. The discussion illuminated the complexity of this issue:

- *“I think predominantly boards [in the past] have been accountable to employees.”*

- *“In the last decade, there has been a change in the nature of what ‘shareholder’ means. We’ve moved away from mostly long-term investors to a much greater diversity of interests in terms of time period and risk-reward appetite. There is a divergence of behaviors between short-term and long-term investors, so it’s very difficult for the board to delegate risk-reward decisions to shareholders. We have to take accountability for that judgment and for explaining it to the investor community.”*
- *“The cultural aspect is important. In the US, it is 90% shareholders; in the UK, it’s 60% shareholders; in Japan, it’s 10%.”*
- *“The word ‘predominantly’ is also important. You make some trade-offs in these decisions.”*

How can banks be made great?

The Gordian knot of governance debate – the issue of shareholder primacy – was cut by the verbal sword of one director who said, *“A CEO [from outside the financial sector] described his main job as maintaining the strength and competitiveness of the firm over the long run. There was no specific mention of shareholders or investors.”* Another stated simply, *“In the long term, [the interests of] shareholders and stakeholders meet.”* Business Roundtable¹⁵ recently researched why the public views big business with such mistrust. It found that the public defines “performance” quite differently than do investors and boards. At the top of the public list of corporate performance attributes were “expanding employment,” “great products, services, and brands,” and “good community citizen.” Lowest on the list were “financial performance” and “stock price gains.” For investors and compensation committees of the board, the order of the list of attributes defining good performance was the reverse.

Although this difference in priorities may seem on the surface to be irreconcilable, summit participants’ thoughts on the long-run responsibilities of the board suggest a good deal of common ground:

- *“The biggest challenge is steering a steady course in the face of exaggerated expectations in turbulent markets.”*
- *“What keeps you awake at night? Working on keeping the board focused on strategy issues, and the key assumptions underlying.”*
- *“We also get drawn [into] ethical decision making: a lot of corners were cut on the ethical front in the name of greed. We should put our hands up and say, ‘We are not getting in that business.’”*
- *“Going forward, ‘doing the right thing’ may need to be a more important factor in deciding on what we will and will not do.”*
- *“At the end of the day, building trust is more than just results. [My bank] is a unique institution in [my country]. Our CEO got results, he communicated with regulators and*

politicians, and he still got criticized in the press. Trust is hard to build up, but easy to lose. You have to be transparent and treat people with frankness and openness.”

- *“[Financial] results are some, but not all, [of the factors] involved in restoring trust. You have to build up a franchise. The banking industry used to be the most trusted.”*

Some boards have begun debating the merits of making sustainable performance¹⁶ the super-ordinate goal of the firm. As such, it would become the foundation for strategy, define performance metrics, and frame the structure of compensation plans.

Key to the board’s success is its rededication to making a meaningful difference

Much has been written and said about how boards should operate, who should serve on them, and what their specific responsibilities should include. But the core question is whether and how boards affect the key judgments and decisions of the corporation in the interests of sustainable performance.

Sir David Walker, in his *Review of corporate governance in UK banks*, declares that the core responsibilities of non-executive directors are “to ensure that there is an effective executive team in place; to participate actively in the decision-taking process of the board; and to exercise appropriate oversight over execution of the agreed strategy by the executive team.”¹⁷ Research participants consulted prior to the summit echoed this view. “The board’s basic role is oversight, setting the tone, and hiring and firing the top team,” stated one director. An institutional investor also framed the board’s fundamental responsibilities in a set of three: “making robust strategic decisions, managing risks, and playing a role in the accountability chain.”

It is easy to agree on core responsibilities. But as they discuss their vision for governance in the post-financial crisis era, FI leaders are facing a much more challenging question. As one director put it, *“Is our mandate enough, or should we get involved further? [That’s] the number one question we’re asking these days.”*

Research participants believe that boards will inevitably have to get more involved in their businesses. Hector Sants, CEO of the FSA, made this clear in a recent speech, stating that “market events support the view that non-executives, in particular, must play a greater role in the oversight of executive management.”¹⁸ At the summit, Ms. Dewar commented, *“We observed a passive relationship between executives and non-executives ... There were dominant CEOs who couldn’t be challenged.”*

One former Wall Street executive stated, “In recent years, boards [got more involved] ... But if in recent years we moved down to 10,000 feet, we may need to be at the 2,500-foot level in the future. Boards will have to get more involved in the weeds.”¹⁹ During pre-summit conversations, a participant asserted, “[Boards need to] look at decisions, business plans, where the company is allocating capital – input from a tactical as well as a strategic perspective.”

Directors know it will be difficult to strike the right balance between raising levels of engagement and involvement and avoiding trespassing into management terrain, particularly in the face of escalating regulatory, legislative, and shareholder demands. Speaking prior to the summit, one regulator observed sympathetically, “The pronouncements from different [regulators and supervisors] always have the line ‘and the board should consider X’ or ‘the board should approve Y.’ It’s almost a throwaway line – I’m not sure people really consider the implications for the board’s activities.”

Impact versus activities

Often lost in the debate over where to draw the line between management and board responsibilities and how much time directors should devote to their board duties is the issue of making a meaningful difference. How can the board and individual directors accomplish this?

Summit participants expressed their commitment in many ways:

- *“I am convinced that good governance can make a difference. I would like to explore the link between strategy and the activities of the risk committee more. How can we get better at seeing around corners and get away from the models?”*
- *“Regulators will force a different relationship between executives and non-executives. There will be a different level of intensity of engagement on the part of boards. I don’t think the business of rethinking what an effective board is is finished yet.”*
- *“[It is clear that summit participants] truly care about corporate governance and building back trust in the economic system. They are also focused on ensuring our institutions do the right thing.”*
- *“[Our CEO] freely admitted that he doesn’t know it all, which is fine. He uses the board in a consultative way, not just as an oversight [function].”*
- *“Our risk committee approves the risk appetite. This led to some challenging discussions with management. No doubt that regulators and customers will be looking to committees to take a greater role in decisions.”*
- *“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 [that] the board is in the second seat, responding to management’s proposals.”*

Impact explored in three companion *ViewPoints*

Each of the three companion pieces to this *ViewPoints* expands on high-impact approaches that boards can take toward the way they operate, their role in risk governance, and their responsibilities with respect to compensation.

- “Risk governance in a new era” explores new approaches to understanding risk, determining risk appetite, setting the risk agenda, and balancing and integrating risk decisions with strategy and performance goals.
- “Banker compensation at a crossroads” discusses the challenges boards face in shaping new compensation policies that conform to the new regulatory requirements and take account of public and political pressures to rein in pay.
- “Building a high-impact, effective board” addresses the issues of engaging with and challenging management, getting the right experiences into the boardroom, and gaining access to internal and external information – all while respecting the line between management and the board.

Breadth, depth, and relationships are required

The three *ViewPoints* show unequivocally that board members must have a broad perspective and must engage with their responsibilities deeply. Consider the director’s task in risk governance:

- **Risk governance must be conducted in a broad context.** What kind of bank do we want to be? What strategies and business models are central to our approach? What are our growth aspirations? What level of returns are we aiming to produce through the cycle? What depth of risk capabilities and talent do we have relative to competitors in our lines of business? These are important questions for the whole board, but especially for the risk committee.
- **Risk governance requires immersion in the details.** At the summit, one participant noted that the most succinct risk document provided to the board is 40 pages long; any further streamlining risks losing vital information. Risk committee members need to grasp the core economics: return on equity by business line across the cycle. New products are born deep within lines of business; members need insight into these. They need a clear fix on the human talent pool. External advice of some sort is required.

These dual requirements present a conundrum to directors. Can they be both broad and deep? One summit participant cautioned, *“Directors can’t get so in the weeds that we lose our independence and end up getting lost in the journey of each decision.”* This issue comes up in almost all discussions on strengthening the way FI boards operate.

The ability and willingness of directors to probe management with smart questions is important, but not enough. Increasingly, board members must also cultivate relationships – and must do so in several domains.

Building a relationship with the CEO is important, but board members should also reach out to the next layer of management as well. Risk committee members should build relationships not only with the chief risk officer (CRO), but also with those who are providing insight and data to the CRO.

Regulators and shareholders also expect more direct contact with board members. At the summit, Bill Rutledge, the executive vice president of the Bank Supervision Group of the Federal Reserve Bank of New York, commented, *“We are trying to have more interactive dialogue with non-executive directors, including one-on-one discussions ... We need to get a credible sense that the board is asking good questions of management.”* For their part, board leaders at the summit saw the value in such relationships:

- *“Regulators want more direct contact with non-executives, and in the UK, there is a strong movement from shareholders. Together, [regulators and shareholders] will push non-executive directors to put pressure on management. Inevitably, the relationship between boards and management will change, especially the dynamic with the CEO.”*
- *“[Regulators are] under huge pressure, and so the danger that they will get into compliance mode is huge, because they need to respond and show action. The more we are proactive, which is in our self-interest, the less they will have to do things that they know, in their heart of hearts, they aren’t capable of. We need to have honest, open communications with our regulators.”*

At the summit, Credit Suisse CEO Brady Dougan described how his firm ensures its directors gain the insight and foresight possible only through breadth of understanding, grasp of the details, and relationships with key constituencies. See [“Building a high-impact, effective board”](#) for details.²⁰ As we have noted in prior research,²¹ other models are also possible and individual FIs will ultimately choose the approach best suited to their own context and strategy.

Governance is at a crossroads

The expectations for post-crisis bank boards need to be considered in the context of governance reform. Summit participants have, cumulatively, over 200 years’ experience serving on more than 50 corporate boards in the North America and Europe. Many of these experienced directors and former CEOs expressed great concern about the unintended consequences of intrusive regulatory oversight, ill-considered legislative agendas, political pressure, and certain specific initiatives, including say on pay and proxy access.

- *“The scenario that worries me most is having more instability in the boardroom, contested elections, higher turnover, shorter-term directors, and less institutional memory as a result, with the only stability being the CEO. This will cause greater instability in governance and oversight, not less.”*
- *“With contested elections, I can’t imagine who’d run. I know I [wouldn’t] stand for an election, and I don’t think anyone else on my board will, either. Boards won’t think out longer than six months.”*
- *“The potential for chaos across the landscape is significant, as shareholder activists are aided and abetted by [proxy advisory firms]. The quality of people on boards, and therefore of governance, will decrease. There’ll be more special interests on boards.”*

- *“A not-inconsequential segment of the population thinks that governance has failed. The country is moving with the culture of change. There’s significant risk of legislation ... We need to restore our credibility. Unless things turn around, boards have to expect more legislation.”*

Directors would like to engage constructively in the public discussions on how to improve corporate governance. But they have no collective voice and few opportunities to speak out.

- *“We have to be more vocal than we have been. We have an important role to play in educating people, communicating what the unintended consequences [of some proposals] might be, and about the level of knowledge that is needed to be really effective in the boardroom.”*
- *“Some forums do exist [to discuss governance issues], but they tend to be shouting matches, without meaningful dialogue. The US is so dominated by the legislative and electoral cycles.”*
- *“We’re at a dangerous crossroads, so it’s important to be a voice in the dialogue. We need to engage; there’s no counter to the groundswell out there against us.”*

★ ★ ★

Restoring trust in banks by building great institutions for the long haul may be the board’s most urgent responsibility. Directors are getting no shortage of advice on how to do so – from regulators, shareholders, legislators, management, governance advocates, and the general public.

Only the board can sort through the competing agendas these groups advance. Only the board, in partnership with the bank’s senior management, can shape a coherent and consistent strategy that assures sustainable performance. And as one summit participant observed, *“Boards [which] do better on this will end up with a competitive advantage.”*

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.

The perspectives presented in ViewPoints are the sole responsibility of Tapestry Networks and do not necessarily reflect the views of any individual FI, its directors or executives, or Ernst & Young. Please consult your counselors for specific advice. Ernst & Young refers to all members of the global Ernst & Young organization. The copyrights on this material are jointly held by Tapestry Networks and Ernst & Young. ViewPoints may be reproduced and redistributed, but only with attribution. If reproduced substantially or in its entirety, it should include all copyright and trademark legends.

Endnotes

- ¹ 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.
- ² In this document, "director" refers to non-executive, non-employee board members on a firm's unitary or supervisory board.
- ³ 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.
- ⁴ 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. Comments by summit participants are shown in italics.
- ⁵ See, for example, the High-level Group on Financial Supervision in the EU, *Report* (Brussels: High-level Group on Financial Supervision in the EU, 2009), available at http://ec.europa.eu/commission_barroso/president/pdf/statement_20090225_en.pdf, and Financial Services Authority, *The Turner Review: A regulatory response to the global banking crisis* (London: Financial Services Authority, 2009), available at http://www.fsa.gov.uk/pubs/other/turner_review.pdf.
- ⁶ 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.
- ⁷ Micro-prudential risks pertain to individual institutions, while macro-prudential risks pertain to an entire economic system. Here and throughout the document, discussions of risk and risk governance refer to micro-prudential risk.
- ⁸ Tapestry Networks, *Shaping bank governance in a new era: Enhanced oversight versus radical reform* (Waltham, MA: Tapestry Networks, 2009), 2.
- ⁹ International Corporate Governance Network, *Second Statement on the Global Financial Crisis* (London: International Corporate Governance Network, 2009), 1. Available at http://www.icgn.org/files/icgn_main/pdfs/news/icgn_statement_on_the_financial_crisis_23_march_09.pdf.
- ¹⁰ Senior Supervisors Group, *Risk Management Lessons from the Global Banking Crisis of 2008* (Senior Supervisors Group, 2009), 4. Available at http://www.newyorkfed.org/newsevents/news/banking/2009/SSG_report.pdf.
- ¹¹ Tapestry Networks, *Shaping bank governance in a new era: Enhanced oversight versus radical reform*, 3–4.
- ¹² *Ibid.*, 7.
- ¹³ Julie Dickson, "Economic and Financial Turmoil: are there Lessons for Boards?" Remarks to the 2009 Financial Services Invitational Forum, Cambridge, Ontario, May 7, 2009. Available at http://www.osfi-bsif.gc.ca/app/DocRepository/1/eng/speeches/fsif0509_e.pdf.
- ¹⁴ Advisory Committee on the Future of Banks in the Netherlands, *Restoring Trust* (Advisory Committee on the Future of Banks in the Netherlands, 2009), 14. Available at <http://www.nvb.nl/scrivo/asset.php?id=290353>.
- ¹⁵ The Business Roundtable is an association of chief executive officers of leading US companies with more than \$5 trillion in annual revenues and more than 12 million employees. Member companies comprise nearly a third of the total value of the US stock markets.
- ¹⁶ "Sustainable performance" refers to the underlying long-term performance trend of the firm. The firm will see year-to-year variability and volatility in operating performance and total return to shareholders around this trend.
- ¹⁷ David Walker, *A review of corporate governance in UK banks and other financial industry entities* (London: HM Treasury, 2009), 33. Available at http://www.hm-treasury.gov.uk/d/walker_review_consultation_160709.pdf.
- ¹⁸ Hector Sants, "The Crisis: the role of investors." Speech at the NAFP Conference, March 11, 2009. Available at http://www.fsa.gov.uk/pages/Library/Communication/Speeches/2009/0311_hs.shtml.
- ¹⁹ Tapestry Networks, *Shaping bank governance in a new era: Enhanced oversight versus radical reform*, 12.
- ²⁰ Tapestry Networks, "Building a high-impact, effective board," *ViewPoints*, November 2009. Available at http://www.tapestrynetworks.com/documents/Tapestry_EY_BGLN_Nov09_View4.pdf.
- ²¹ See Tapestry Networks, *Shaping bank governance in a new era: A revised compact with management and shareholders*.

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

Risk governance in a new era¹

The Senior Supervisors Group noted in March 2008 that financial institutions (FIs) would “face increasing pressure to understand the risk they face, to measure and assess such risks appropriately, and to take the necessary steps to reduce, hedge, or otherwise manage such risk exposures.”² With the benefit of hindsight, this seems like a considerable understatement.

Since the early days of the financial crisis, leaders both within and outside the financial services industry have highlighted the need for boards to improve in the area of risk governance. As one director³ put it at the Financial Institution Directors Summit⁴ on October 5 and 6, 2009, “*The biggest [challenge] that I struggle with is dealing with the balance between growth, returns, and risk management. All of our assumptions didn’t work.*”

This *ViewPoints*⁵ outlines the discussion at the Financial Institution Directors Summit on the future of risk governance and draws upon extensive research developed in preparation for the summit meeting.⁶ See “[About this document](#)” (page 14) for more on the research and “[FI Directors Summit participants](#)” for a list of attendees.

At the summit, directors and guests discussed four imperatives for boards as they tackle the issue of risk governance:

- **Setting risks in a strategic context** (*Page 2*)

Directors emphasized that board-level risk discussions must take place in the context of firm strategy and performance goals. Board leaders recognize their responsibility to actively challenge management on the question of whether the firm has the necessary resources, including financial and human capital, to be successful in executing the firm’s strategy.

- **Ensuring risk appetite is more clearly defined and better understood** (*Page 3*)

Board leaders view risk appetite as perhaps the most critical component of an overall board-level risk policy, because it acts as a clear statement of the firm’s strategic intent. Virtually unanimously, directors at the summit and participants in prior research believe bank board members need to have greater, and more constructive, involvement in their firms’ decisions regarding risk appetite. Challenges related to risk appetite include clarifying the board’s role, developing well-informed definitions, and communicating to external stakeholders.

- **Defining the risk governance agenda** (*Page 6*)

In the post-crisis era, FI boards need to clearly define the risk governance responsibilities they will assume. Summit participants expect to remain more actively engaged on a broader set of risk priorities than they were before the crisis. They highlighted capital allocation, new business risks, and risk-adjusting compensation as issues that have risen in importance on the board’s agenda in the current environment.

- **Enhancing the board's understanding of risks** (Page 9)

To support robust discussion and debate on risk matters, directors require high-quality information and insight from both within and outside the firm. Streamlining risk communications to the board, establishing a productive relationship with the chief risk officer (CRO), and drawing upon independent risk perspectives all contribute to building the board's risk knowledge.

Setting risks in a strategic context

The global financial crisis that has gripped the banking sector revealed that boards and management did not fully appreciate the overall level of risk to which their institutions were exposed. Prior to the summit, one regulator asserted, "Boards didn't ask enough questions to ensure they understood [their institutions'] risks or [to] identify the concentration of risks. They didn't demand that risks be made transparent." A chief executive acknowledged, "[Over] the past few years, we thought we had dispersed risk. We forgot the basics: the identification, allocation, and pricing of risks."

In the wake of the crisis, board members report an evolution in thinking about the board's role in risk matters. Where in the past many FI boards focused primarily on ensuring their institutions' risk management and control processes were sound, now directors are keenly aware that in addition, they must engage much more actively with the substance of the institution's risks and ensure those risks are viewed in the appropriate strategic context. "[We] can't have a risk discussion without [discussing] strategy. There has to be a link between our strategy, the resources [the firm] has available, and our performance objectives ... This is a key responsibility of the board, and it can't be delegated," stated one summit participant. Another agreed: "I am interested in [how the board] can move beyond the regulatory compliance process to an understanding of management's assumptions, particularly on risk." Summit guest Brady Dougan, the CEO of Credit Suisse, noted the essential role that boards and committees play in ensuring management does not get overwhelmed by the details of complex risk matters: "The risk committee helps keep us focused and gives us perspective. Management can often get into the weeds, and the board can be really helpful in getting us to step back."

Directors at the summit emphasized, however, that keeping board-level risk discussions in a strategic context does not mean that those discussions stay at an abstract or superficial level. They identified two areas in particular where boards will need to go deep:

- **Understanding the business.** The board, and in particular the committee tasked with responsibility for risk oversight, needs to understand each line of business and its respective volatility so that it can probe management's assumptions on risk. "We have to understand the ROE [return on equity] ... by business, over the [economic] cycle," commented one director. Another agreed: "We have [multiple] lines of business at my bank, and we understand what the ROE should be for all of them. If one of them should be earning 20%, but is earning 30%, [the board] is going to go digging. That's too much risk."

- **Understanding management capabilities.** Within each of those lines of business, boards need a greater degree of familiarity with the level of management capability relative to the competition. One director noted, *“If management came to our board and said ‘We want to do more business in Russia,’ we’d say, ‘We want to know who our managers are in Russia.’”* Another summit participant summed it up simply: *“We have to recognize [risk] isn’t just the numbers. It’s the people. That’s why the board has to get more involvement and face time with the key executives.”*

Summit participants concluded that above all, boards must stay actively engaged in guiding their firms’ strategy and business model choices: *“Depending on the volatility you are ready to accept,”* one director observed, *“you decide what kind of institution you want to be ... and what type of shareholders you want to have. The board should set that definition.”* Participants expect the challenges in this regard – ones that may include significant changes to the industry’s structure – will only increase as global economies continue to recover and pressure for returns comes to the fore: *“What happens when ... fear [gives way] to normalcy?”* One participant reported seeing things change already, for some shareholders: *“A number of our investors have already moved on from the crisis. They’ve said, ‘You can’t make money only serving clients, and you’re holding too much capital.’”*

Ensuring risk appetite is more clearly defined and better understood

Banking is fundamentally a risk business; as such, risk appetite can be broadly defined as “a measure of the amount of total risk [an institution] is willing to accept in pursuit of its business objectives and goals.”⁷ Thus, it can be seen as one important articulation of the strategy agreed by the board and management. In a recent report, the senior FI supervisors from seven countries stated bluntly that “most firms [do] not present much evidence of active board involvement in overseeing the setting or monitoring of the company’s risk appetite, or of board understanding of the firm’s current risk position relative to its risk appetite.”⁸ Key challenges highlighted by summit participants include clarifying the board’s role in risk appetite, defining risk appetite, and communicating risk appetite to external stakeholders.

Clarifying the board’s role in risk appetite

Prior to the summit, a regulator commented, “Risk appetite is where the board’s role really begins.” But what should that role be? One participant asked, at the outset of the summit, *“Where does management stop and the board take over [with respect to risk appetite]?”* Directors largely agreed that risk appetite should be set by management and approved, after sufficient examination, by the board.

Regulatory guests concurred with this view, but emphasized their expectation that directors will engage much more actively on risk appetite than they have in the past. Sally Dewar, the managing director for risk at the UK’s Financial Services Authority (FSA), stated, *“Management should set risk appetite, but the board should delve into the details enough to get comfortable with it.”* Bill Rutledge, the executive vice president of the Bank Supervision Group of the Federal Reserve Bank of New York, noted that regulatory authorities want to know *“how deeply is the board*

engaged in risk appetite? Are they monitoring the actual [risk level] versus what was set? Are they [ensuring management is] being forward looking in ... identifying action steps to be taken if risks do materialize and losses show up? We view these as challenges for boards.”

Directors and executives also believe there is room for boards and key committees to get more deeply involved in exploring and, where necessary, challenging management’s proposals on risk appetite without crossing the line into management’s responsibilities. At the summit, several board leaders highlighted instances where their boards had pushed management to withdraw from certain businesses, because they felt the associated risks were higher than those perceived by management. “It is within the board’s power to say, ‘We are willing to take this amount of risk under the following assumptions,’ without getting involved in day-to-day ... business decisions,” stated one director prior to the summit. Another board member emphasized, “The board needs to be active [in risk matters], but at some point there’s a danger of becoming another organ of management. It’s a better idea to simply replace management if we don’t trust them, rather than crossing that line.”

Defining risk appetite

A statement on risk appetite sets forth the company’s general attitude toward risk, consistent with its strategic objectives. At the conceptual level, this is both simple and profound. In a pre-summit conversation, one director observed, “It’s the great balance of [this] business: [how much can we] grow topline revenue without accepting a degree of risk that puts the business in jeopardy? We have to find that sweet spot.”

Directors agree with regulators that the board needs to be more involved in risk appetite than in the past: “*We can be successful if we know how to measure, monitor, and get paid for the risks we are taking,*” asserted one summit participant. Yet participants report that calculating specific risk appetite limits, or tolerances, remains a significant challenge. As a director said at the summit, “*[Risk appetite] is a great term. Everyone uses it. But no one agrees on [what it means]. [Our] regulators think in superficial terms, like leverage ratios. [We’re] like two ships passing in the night. What does risk appetite mean?*”

While research participants agreed prior to the summit that “[risk appetite] is an art and not a science,” and “there is no one single answer for how to do it,” over the course of our research directors and executives shared several principles they have found helpful in improving their approaches to risk appetite definition.

Advice from directors on risk appetite

- **Incorporate a forward-looking view.** “Stress-testing [risk appetite assumptions] should help you fight the next war. It should focus [attention] on what could go wrong, not what went wrong the last time,” commented a research participant prior to the summit. Directors at the summit said they are pushing their respective risk organizations to understand more deeply *“what our prospective, over-the-cycle risks will be.”*
- **Draw on qualitative as well as quantitative analysis.** Prior to the summit, a research participant observed, “Everyone got seduced by what [could] be quantified, like VaR [value at risk] per unit of equity. But most of the really big risks are unquantifiable.” An executive noted, “We want the board focused on the softer elements [of risk appetite]: where are we on the risk spectrum? Are we being conservative or aggressive? How is management planning to turn the [risk] dial up or down?”
- **Promote extensive dialogue.** One director put it simply: “[Risk appetite] should not only be about people looking at a template or dashboard, but also having systematic discussions about ... what the numbers mean.” At the summit, a director shared a similar view: *“You can’t just listen to the CRO ... You need to have a dialogue with the risk takers.”*
- **Develop a carefully integrated approach.** Prior to the summit, an executive commented, “In many banks, [risk] is siloed. Metrics aren’t comparable and therefore have been difficult to aggregate.” However, FI leaders caution that in the absence of appropriate context, integrated risk tolerance data often does not provide enough information about the complexities of FI risks, especially those that are off-balance sheet (e.g., structured investment vehicles), and in fact may be misleading: “Value-at-risk numbers net risks down considerably. You can’t see who’s betting the bank.”
- **Match competencies with risk tolerances.** Summit participants agreed that *“risk appetite should be coordinated with the type of people that take the risk.”* In a conversation prior to the summit, an executive commented, “Our focus is as much on making sure we are taking a high enough risk in the areas where we have strong competencies ... as it is [on] reducing risk in areas where we are not as strong.”
- **Understand the limits of risk appetite calculations.** In pre-meeting conversations, an executive encouraged directors to remember that “it’s as important to understand what a model isn’t telling you as what it is telling you.” Another research participant observed, “Fiction of control is very dangerous. The biggest risk of all is if we start believing in the numbers 100% – [we need] a healthy dose of skepticism.”

Communicating risk appetite to external stakeholders

Several summit attendees noted a worrisome trend: *“There’s pressure [from regulators] to reduce risk to a number.”* As one research participant commented prior to the summit, “If we learned anything from the financial crisis, it’s that single measures of risk are not informative.”

Directors questioned how well regulators and other key stakeholders, such as institutional investors, understand the nuances of the risk-return frameworks underpinning management and board deliberations on risk appetite. *“Do they understand that it’s a risk-reward issue, not just about risks?”* asked one board member. Another participant reminded the group that while financial institutions are in the business of taking risks to make money, *“Regulators get no upside for taking risks, only downside. So they have to be in the business of preventing mistakes.”*

In this context, directors view with skepticism proposed requirements for increased disclosure on FI risks, such as the Walker Report’s recommendation that a report from the risk committee be formally included as a separate component of the firm’s annual report.⁹ As one director put it, *“I don’t know how we can communicate usefully on risk in more detail.”* In our pre-summit conversations, a former regulator expressed the same doubt: “I worry about the impact [of more] disclosures. You want a risk committee to [consider extreme scenarios], but reporting it publically could pose a problem.” Several summit participants suggested that more open dialogue with stakeholders, rather than more required reporting, would be a better approach: *“In the public domain, institutions reveal very little about how boards deal with risk,”* one director observed. *“[Maybe] shareholders and others [would] be better off understanding the dialogue behind our risk philosophy.”* Another board member suggested, *“Maybe we will have to meet with key institutional investors to discuss risk, rather than relying on boilerplate disclosures.”*

Defining the risk governance agenda

At the summit, one board leader commented, *“I am rethinking what we mean by risk ... There has been a distinct change of emphasis [in our boardroom discussions] ... [and] externally, regulators have higher expectations on directors to make macro risk judgments.”*

In discussions leading up to the summit meeting, directors said they intended to “substantially increase [our] level of engagement ... [in] risk oversight.” But many struggle to define what this means in practice. As one board member observed, “Regulators and commentators say ... ‘Every institution should adopt [its] own approach.’ That’s fine, but we need a place to start.”

A number of boards are examining and revising their risk agenda – their risk governance responsibilities and priorities – as a starting point. This is no small task today, when, as the Basel Committee notes, effective risk management “is not limited to credit, market, liquidity and operational risks, but incorporates *all* material risks. This includes reputational, legal and strategic risks, as well as risks that do not appear to be significant in isolation, but when combined with other risks could lead to material losses.”¹⁰

While boards must grapple with all of those risks, summit participants identified a number of risk governance priorities that are especially salient for board leaders and senior executives in the current environment:

- Ensuring capital allocation is appropriately risk weighted
- Probing the risks of new business activities
- Ensuring compensation arrangements are appropriately risk adjusted

Ensuring capital allocation is appropriately risk weighted

In a conversation before the summit, a board leader outlined a series of questions he believed directors need to ask their management teams with respect to capital allocation: “What’s our strategy for how [capital] is allocated? Is it in the right places to drive a good, risk-weighted return at the right risk appetite? What happens to us in a downturn? Which assets are liquid, and which are not? If we hit a crisis, how will we generate liquidity?”

At the summit, one director noted that while *“allocating capital is the CEO’s job,”* the board must actively question management’s assumptions to uncover any potentially faulty reasoning. One director described just such a situation: *“At [our company, management] wanted to make an investment, and we told them they didn’t have enough capital against the risk. They said, ‘If [we] put that capital against the risk, [we] wouldn’t want to be in the business.’ We said, ‘Exactly.’”*

Potential changes to liquidity and capital requirements are also pushing capital strategy higher on many audit and risk committee agendas. Supervisory authorities are working on enhancing international capital standards to mitigate tendencies toward procyclicality, a phenomenon whose dangers the financial crisis demonstrated dramatically. Mr. Rutledge noted that regulators will be asking FIs *“How well do you assess how much capital is needed to absorb losses, and still be able to operate as a going concern? How well do [banks] think through the action steps needed to restore capital under adversity?”*

However, FI leaders are concerned about regulators’ commitment to convergence of those standards: *“I was surprised to see the regulators’ behavior [during the] crisis,”* commented one director. *“The cross-border aspects of regulatory reform got lost ... Everyone was fighting for their own jurisdiction.”*

Members of the Institute of International Finance are extremely apprehensive about what they see as a loss of momentum toward harmonization of standards, and they are urging regulatory authorities to resist local “self-sufficiency or stand-alone approaches to liquidity regulation.”¹¹ A former regulator with whom we spoke prior to the summit predicted pessimistically, “Banks will face more pools of trapped capital in the future, because there will never be international agreement on liquidity requirements.”

Probing the risks of new business activities

The Basel Committee makes the following recommendation:

Before embarking on new activities or introducing products new to the institution, the board and senior management should identify and review the changes in firm-wide risks arising from these potential new products or activities, and ensure that the infrastructure and internal controls necessary to manage the related risks are in place.¹²

Our research conducted prior to the summit meeting uncovered support for this position. One executive observed, “A lot of the problems that the industry faced [in the financial crisis] were a result of insufficient thought and analysis given to the risks of products that were new or had morphed ... As a result, getting regular attention about [new-initiative] risks at the board level is very appropriate.” Another research participant recommended that FI directors place high priority on gaining “a thorough understanding of how something goes from idea generation all the way through to getting on the balance sheet.” A summit participant observed, *“Products like CDOs were lost in the system, deep in the lines of business. Firms didn’t stop to ask, ‘Have we back-tested our processes in light of these new products and risks?’”*

However, several summit participants also pointed out that *“[often] we can get lost in the definition of what’s new and what’s not new,”* since *“new products tend to be re-engineered old products.”* In an earlier conversation, a research participant expressed similar caution: “Pre-launch reviews of new businesses are not enough ... Failure to challenge the business models and risk/reward characteristics of established businesses has [also been] a problem.”

Rather than focusing on weighing the relative risks of new and established products or businesses, summit participants suggested boards should ask which businesses, based on their risk levels, the firm should be in at all. Describing the board’s involvement at Credit Suisse, Mr. Dougan said it examined *“whether a proposal by management is consistent with our strategy, [and] the risks attendant to that decision – market, operating, control, or reputation risk. We [also] have a process to review new businesses or new products with the board, but only when they are at a certain size or scale.”*

Summit participants cited businesses such as life insurance settlements, paycheck cash advances, and subprime mortgages as examples of businesses their boards had decided their firms should not enter due to the risks involved, including reputation risk. *“[We directors] should be able to put our hands up and say, ‘We are not getting in that business.’ Going forward, doing the right thing may become a more important factor in deciding what we will and will not do.”* Another board member agreed: *“Risk is about more than the metrics we look at and the products we deliver. It’s about doing the right things in the right way.”*

In conversations leading up to the summit, several directors expressed concern that extensive board or committee involvement in decisions related to new or rapidly growing businesses would slow down decision making to a potentially dangerous degree and would also put the board at risk of stepping into management’s domain. These directors suggested the board can enhance oversight of new-initiative risks by ensuring the chief risk officer has a seat at the table with

sufficient status to engage substantively in decision making: “It’s the board’s responsibility to ensure [the CRO] is in the room when [these] decisions and risk commitments are made.”

Ensuring compensation arrangements are appropriately risk adjusted

Compensation for FI executives has rocketed up the political agenda on both sides of the Atlantic in the last 12 to 18 months, raising complex questions and high emotions. Summit participants discussed compensation in a separate meeting session on October 6, 2009.

The risk dimension of compensation has been a central theme in the regulatory and political debate. Ms. Dewar of the FSA observed, “*Remuneration was encouraging a high amount of risk taking, based on cash [bonuses], and we are concerned that it hasn’t changed much.*” Other public-sector leaders have made it clear that scrutiny of compensation risk is here to stay and that they will take a more activist approach toward enforcement. In a pre-summit conversation, one regulator cautioned, “We consider [compensation] principles to be rules. So if brilliant people at a bank find a way to follow the rule, but violate the principle, we’ll still fine them.”

For their part, summit participants acknowledge that “*compensation is too high and leads to excessive risk taking.*” They believe that closely linked to the board’s responsibility for approving the firm’s risk appetite is its duty to ensure that financial incentives do not encourage risk-takers (e.g., traders) and senior management to take actions that exceed that appetite. In other words, boards must connect the dots between risk appetite, performance targets, and compensation policy.

At the summit, directors discussed a number of issues and challenges related to effectively coordinating the oversight of risk and reward:

- **Clarifying the distinction between structure and level of banker pay.** Summit participants noted the debate about FI compensation amongst some policymakers and in the press often conflates these two important issues, which must be treated separately.
- **Identifying practical approaches to risk-adjusting compensation.** Where policies were not already in place, board members report a number of changes under way in their institutions to ensure compensation arrangements are consistent with sound risk management.
- **Coping with the unpredictability of the regulatory environment.** Directors observed with concern that the unpredictable global regulatory environment has itself become a risk that FIs must handle – one that increases the likelihood that top talent will migrate to unregulated sectors of the financial world.

Compensation issues are covered in greater detail in the *ViewPoints* titled “Banker compensation at a crossroads.”¹³

Enhancing the board’s understanding of risks

Boards and committees are being pushed to ask tougher questions and to challenge management more actively on risk matters. This has stimulated them to think about how best to establish and maintain a high level of risk understanding in the boardroom: as one summit participant put it,

“How much knowledge does the board need to get us comfortable to stand behind management as they make key decisions?”

At the summit, directors identified several ways to help build the board’s risk knowledge:

- Improve the quality of risk communication between management and the board
- Establish an effective relationship with the chief risk officer
- Obtain independent perspectives on the firm’s risks

Improve the quality of risk communication between management and the board

A summit participant summed up the views of many peers in the room by stating, *“The quality of risk information is really a lifeline for the board.”* Another director wondered, *“Are we being told the right things [by management]? What kinds of questions should we be asking management?”*

Directors report that getting the right risk information has become even more challenging since the onset of the financial crisis because the volume and detail of management’s risk reports to the board have increased considerably. In a conversation before the summit, one director said, *“We’ve been inundated with data; [the committee] was completely underwater.”* This is partly due to a growing number of regulatory requirements for risk reporting, as one director observed: *“We keep asking management why a particular item is in there, and often they tell us it’s because of ... regulations. There’s [so much material]; we ask, ‘What do you want us to read [most]?’ and they say, ‘We can’t tell you.’”*

Some risk executives acknowledge that their own organizations have contributed to the avalanche of information: *“People can have the sense that ‘if I bring a lot of data to the table, I’ve done my job,’ but if you don’t distill the data, we haven’t done our job.”*

Several participants said they are working to overcome obstacles posed by siloed, inflexible information systems in order to provide the board with a holistic view of risks that synthesizes disparate risk data into actionable insight. The Senior Supervisors Group recently expressed this same concern, noting that:

Firms are constrained in their ability to effectively aggregate and monitor exposures across counterparties, businesses, risk strands, and other dimensions because of ineffective information technology and supporting infrastructure ... [Improvement projects] will require a significant dedication of funds, sponsorship, and commitment from the board and senior management.¹⁴

Enhancing risk reporting to the board

Summit conversations and prior research uncovered a range of ideas on how to manage the volume and quality of risk information flowing to the board:

- **Management should take the lead in distilling information.** In his comments at the summit, Mr. Dougan highlighted the difficulty of *“tak[ing] very complex businesses with complex issues and distilling [them] down to the key risks involved.”* In Mr. Dougan’s view,

“it’s management’s job to make it digestible [for the board].” One director agreed: *“Management has a responsibility to tell us what the [main] risk issues are.”* In the course of our research, risk executives shared approaches they are using to enhance risk communication to the board. See *“Techniques for improving management-board risk communication”* below.

- **The board needs to work with management to get the right balance of information.** In a conversation prior to the summit, one CRO, whose firm has a long-standing board-level risk committee, advised directors to take the time to “work with management on the form as well as the content of the risk information management is providing to them, [to] make sure [they] get maximum value ... It can take a few iterations to get it right.”
- **Risk information should not be distilled.** One board leader asserted that, for key committees at least, risk information should be provided to the board in unabridged form: *“At the risk committee at my bank, we decided a few years ago that we would get exactly the same information that was going to the management team. There shouldn’t be two sets of [risk data]. It was the best decision we took.”* Another participant noted, *“You can’t have a one-page document. The most succinct risk document we have is 40 pages long.”*

Techniques for improving management-board risk communication

Risk executives discussed the following techniques in pre-summit conversations:

- **Plain language.** Risk executives are striving to remove excessively technical language and risk jargon from committee communications. One said, “I push my team to put key points on one page, in plain [language].” Another CRO described his organization’s risk committee materials as “text heavy – more like case studies than big [slide] decks. It helps us to explain things to smart but non-technical directors.”
- **Consent agendas.** At one financial institution, the risk organization makes a clear distinction between presentation of requested updates or information required per regulatory mandate, “where there is little discussion beyond a short Q&A,” and more in-depth agenda items, where extensive discussion is needed. “Previously, every single [agenda item] had a long presentation along with it, and it took up tremendous amounts of time.”
- **Tailored communications.** Several CROs highlighted the benefits of segmenting information for different audiences. At one bank, committee reports are divided into a core, which contains all required and pertinent information, and more technical appendices, which contain additional detail for members with deep risk expertise.

Coordinating risk discussions at the board

Regardless of how risk reports to the board are structured, summit participants agreed that it is essential to coordinate discussion of the information among key committees and between committees and the full board. One director noted, *“I’m concerned about how we make sure we*

don't have gaps in what we are doing, or that we end up creating silos in [risk] oversight.” Mr. Dougan observed there is still “some ambiguity around where the risk committee ends and where the audit committee picks up. About half [our] sessions are joint sessions ... We try to err on the side of overlap, not allowing things to fall between the cracks.”

In addition to joint committee sessions, board leaders point to cross-committee memberships and open-invitation committee meetings as tools that help ensure adequate awareness about, and coordinated discussion of, key risk information without creating confusion about committee roles. And substance is more important than form: speaking prior to the summit about coordination between the risk and compensation committees, one research participant emphasized, “[It can’t] just [be] passive information exchange. [Committee members] need to steer each other toward what’s important and what can go wrong. They can’t just trade board papers and say they checked the box.”

In the end, each FI will make its own choices on allocation of risk responsibilities across committees, including whether or not to have a separately constituted risk committee. These choices will be influenced by firms’ specific operating context, including corporate and banking law, public company listing requirements, and sector regulations.¹⁵

Other Tapestry Networks research reveals that some boards are mapping current full-board and committee-level risk governance activities as an input to discussions about committee structure and information flows. The goal is to clarify the extent of existing workloads across committees, assess effectiveness, and identify potential opportunities for improvement.¹⁶

Establish an effective relationship with the chief risk officer

Board members and risk executives agree that an open line of communication between the CRO and the risk or audit committee (especially the chair) is the cornerstone of a productive working relationship with the risk organization, which, in turn, is essential for effective risk governance. Mr. Rutledge told directors that this relationship is also of interest to regulators: *“We will be looking at how the board engages with the CRO. How much and how often do they interact? Who sets the agenda – is it the CRO, or is it more of a two-way street?”*

Summit participants identified a number of issues on which they have been, or will be, engaging with chief risk executives. *“We [check with] our CRO about the stature of his organization: is it a serious function, or one that is merely tolerated?”* commented one director. Another stated, *“[Boards] need to understand the process that the CRO goes through to get [risk] information.”*

Several directors noted that they are encouraging their CRO to take a broader perspective on the firm’s risks – just as the board itself has been doing: *“We find the CRO spends too much time on past or current risks, and not enough on forward-looking risks. We want to know [more] about our prospective risks. Where are our exposures?”* Another director agreed, *“Risk functions in financial institutions tend to be focused on financial risks. What [they] look at less are regulatory risks and other policy risks such as cap and trade, the health care debate – these affect our clients [and] our investments, and thus create risks ... I am not sure if the CRO is really attuned to that.”*

For their part, CROs welcome the leadership of directors, especially committee chairs, in setting the agenda for risk discussions in the boardroom – otherwise, as several CROs commented at a recent gathering, “management [will be] managing the board.” These risk executives believe that in order to be successful at risk governance, directors should be “prepared to put in the work [to understand risk matters], seek out all possible sources of [risk information], and ... hold the CRO accountable.”

Obtain independent perspectives on the firm’s risks

Risk committee members and other board directors are increasingly interested in independent risk advice, to complement the information they receive from management. One director declared, “*We are in a new world ... We are seeking a greater degree of external advice on risk.*” While some research participants expressed skepticism about the use of outside risk advisers in conversations leading up to the summit, a larger number were in favor. One participant commented, “It’s amazing more boards don’t [have independent information on risks], but this will change in the future.” A chief risk executive declared, “A good management team shouldn’t mind an independent review of risks. It ought to help us get to a better conversation with the board.”

Board members reported various ways in which they are using outside advisers on risk matters:

- **Risk strategies.** Some directors are commissioning independent experts to “*kick the tires*” on risk assumptions and strategies or to provide perspectives on broad industry trends and changing risks in the market environment.
- **Risk management and governance structures.** Several FIs engage outside experts to evaluate board and management-level committee protocols as well as control and approval processes.
- **Risk reporting.** Some banks are seeking independent assessments of the quality of their risk reporting, including the aggregation of firmwide data, the selection of key risk metrics, and the quality and format of information reaching the board and senior levels of management.

FI leaders expect existing advisers will also be pressed for perspective on risk matters. “The external auditors should have an opinion [on risks],” asserted one chief executive in an interview earlier this year. A leading report on bank governance from the Netherlands recommended, “In order for both the Risk Committee ... and the external auditor to work effectively, a periodic exchange of information between the two is required, preferably twice a year.”¹⁷ Regulators and shareholders were also cited as valuable sources of outside insight on firm risks and culture. See [“Building a high-impact, effective board” for further discussion on boards’ access to external perspectives.](#)¹⁸

At the summit, directors observed that boards should not overlook employees as a source of fresh perspectives on risk matters: “*There are executives who can see around corners better than others. We need to spend time with them ... Their insights can be used as a platform [to help the board] probe management.*” Prior to the summit, research participants expressed similar views. One

executive noted, “The risk committee can ask for a special review of risks [from an external adviser] ... but I’d rather focus on making sure the risk committee is hearing the widest possible range of information from inside the company. That may mean [directors] need to get out to different sites and talk to [more] levels of management informally.”

Conclusion

Banks are in the business of taking risks, which means that risk matters will always be central to the board’s responsibilities, given its core role as adviser to the CEO and the management team. Regulators and investors have made it clear that they plan to hold directors much more accountable than in the past for their firms’ decisions and performance outcomes related to risk. These heightened expectations are occurring in parallel with boards’ risk governance responsibilities growing in depth, breadth, and complexity. However, as one summit participant noted, despite all the change, some things remain the same: *“The old ideas about risk may [have] changed, but the questions of how we make our business more profitable and how to move forward are still there.”*

Summit participants believe that discussion of a firm’s risks cannot be held separately from discussions of strategy, and similarly, that risk data and metrics, particularly those related to risk appetite, should not be viewed in isolation. Boards will be spending more time and digging deeper to understand the firm’s risks, working closely with the chief risk executive and drawing on internal as well as external sources of information. Above all, summit participants confirmed that FI board members are ready to take up the challenge and play a leadership role in shaping the future of risk governance in their institutions.

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.

The perspectives presented in ViewPoints are the sole responsibility of Tapestry Networks and do not necessarily reflect the views of any FI, its directors or executives, or Ernst & Young. Please consult your counselors for specific advice. Ernst & Young refers to all members of the global Ernst & Young organization. The copyrights on this material are jointly held by Tapestry Networks and Ernst & Young. ViewPoints may be reproduced and redistributed, but only with attribution. If reproduced substantially or in its entirety, it should include all copyright and trademark legends.

Endnotes

- ¹ 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.
- ² Senior Supervisors Group, *Observations on Risk Management Practices during the Recent Market Turbulence* (Senior Supervisors Group, 2008), 20. Available at http://www.newyorkfed.org/newsevents/news/banking/2008/SSG_Risk_Mgt_doc_final.pdf.
- ³ In this document, "director" refers to non-executive, non-employee board members on a firm's unitary or supervisory board.
- ⁴ 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 Mr. Brady Dougan, CEO, Credit Suisse Group; Ms. Sally Dewar, Managing Director, Risk, UK Financial Services Authority; Mr. Bill Rutledge, Executive Vice President, Bank Supervision Group, Federal Reserve Bank of New York; and Mr. Jim Turley, Chairman and CEO, Ernst & Young.
- ⁵ 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 have given permission for their remarks to be attributed. Comments by these guests and summit participants are shown in italics.
- ⁶ 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.
- ⁷ J. Chris Karow, "Discovering Risk Appetite," *Crosscurrents: The magazine for financial services executives*, no. 31 (Fall 2007). Available at [http://www.ey.com/Publication/vwLUAssets/CrossCurrents_Fall_2007_-_Discovering_Risk_Appetite/\\$FILE/Industry_Insurance_CrossCurrentsFall07RiskAppetite.pdf](http://www.ey.com/Publication/vwLUAssets/CrossCurrents_Fall_2007_-_Discovering_Risk_Appetite/$FILE/Industry_Insurance_CrossCurrentsFall07RiskAppetite.pdf).
- ⁸ Senior Supervisors Group, *Risk Management Lessons from the Global Banking Crisis of 2008* (Senior Supervisors Group, 2009), 23. Available at http://www.newyorkfed.org/newsevents/news/banking/2009/SSG_report.pdf.
- ⁹ David Walker, *A review of corporate governance in UK banks and other financial industry entities* (London: HM Treasury, 2009), 89. Available at http://www.hm-treasury.gov.uk/d/walker_review_consultation_160709.pdf.
- ¹⁰ Basel Committee on Banking Supervision, *Proposed enhancements to the Basel II framework* (Basel: Basel Committee on Banking Supervision, 2009), 13. Available at <http://www.bis.org/publ/bcbs150.pdf?noframes=>. Emphasis in the original.
- ¹¹ Institute of International Finance, *Restoring Confidence, Creating Resilience: An Industry Perspective on the Future of International Financial Regulation and the Search for Stability* (Washington, DC: Institute of International Finance, 2009), 51. Available at <http://www.iif.com/press/press+76.php>.
- ¹² Basel Committee on Banking Supervision, *Proposed enhancements to the Basel II framework*, 13.
- ¹³ Tapestry Networks, "Banker compensation at a crossroads," *ViewPoints*, November 2009. Available at http://www.tapestrynetworks.com/documents/Tapestry_EY_BGLN_Nov09_View3.pdf.
- ¹⁴ Senior Supervisors, Group, *Risk Management Lessons from the Global Banking Crisis of 2008*, 26.
- ¹⁵ To take just one example, research participants operating within the supervisory board structure may be less able than participants on unitary boards to increase their level of engagement and oversight, particularly in critical areas such as risk governance. This constraint may be lifting in some countries, however. In a recent revision to its minimum requirements for risk management, the German Federal Financial Supervisory Authority (BaFin) opened the door for supervisory boards to get more involved in risk matters, including granting them the right to request risk information directly from the internal audit organization. See Federal Financial Supervisory Authority, "New Minimum Requirements for Risk Management (MaRisk): BaFin implements international risk management standards," press release, August 2009. Available at http://www.bafin.de/clin_152/nn_720788/SharedDocs/Mitteilungen/EN/2009/pm_090814_marisk_new.html.
- ¹⁶ Ernst & Young, "A new landscape for risk management and oversight: considerations for audit committees," *InSights*, April 3, 2009, 8. Available at http://www.tapestrynetworks.com/documents/Tapestry_EY_Euro_Insights_Apr09.pdf.
- ¹⁷ Advisory Committee on the Future of Banks in the Netherlands, *Restoring trust* (Advisory Committee on the Future of Banks in the Netherlands, 2009), 16. Available at <http://www.nvb.nl/scrivo/asset.php?id=290353>.
- ¹⁸ Tapestry Networks, "Building a high-impact, effective board," *ViewPoints*, November 2009. Available at http://www.tapestrynetworks.com/documents/Tapestry_EY_BGLN_Nov09_View4.pdf.

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

Banker compensation at a crossroads¹

Concern over banker compensation² has united heads of state, finance ministers, institutional investors, the popular press, and financial institution (FI) leaders themselves, all of whom have expressed frustration (and, in some cases, outrage) over pay levels and bonuses in banking. Compensation, which few believe to be among the most important causes of the financial crisis, is nevertheless a lightning rod issue that galvanizes public support for broad scale bank reform.

Banker compensation truly finds itself at the intersection of risk governance, politics, and public policy. Accordingly, FI boards will find it difficult to ignore the politics and public policy issues that swirl around their compensation decisions.

- Regulators have been very focused on changing the *structure* of compensation arrangements to ensure that excessive risk taking is not incentivized. It makes no sense to reform risk governance and then incentivize imprudent risk taking. Banks themselves largely support revised structural guidelines for keeping risk taking in check, and in some cases have already introduced approaches consistent with regulatory guidance.
- Politicians, on the other hand, have been focused on finding ways to rein in what they, and the general public, consider to be exorbitant pay *levels*. They are offended by high pay in the best of times, but find it intolerable in the wake of the global financial crisis and the huge cost to the public treasury of underwriting banks deemed too big, or too interconnected, to fail.

High pay, notoriously in the form of bonuses, would not be possible without the robust profits derived from banks' capital markets businesses. Consumer and commercial banking (i.e., deposit-taking, payments, and lending) tend to be much less profitable. Accordingly, politicians' ire over pay is not directed so much at community bankers (even though bank failures in 2009 in the US already exceed 100, costing the FDIC over \$25 billion), but rather at the largest global FIs. Goldman Sachs has become the poster child for excessive pay, based on estimates of a 2009 bonus pool which had reached \$16.8 billion by the end of the third quarter.³

The size of FI profits raises public policy issues extending beyond banker compensation. The offending banks are the very institutions that many feel are "too big to fail." The remedies to the important "moral hazard" issue range from an extra layer of required capital to the re-introduction of the Glass-Steagall Act in the US (i.e., the separation of proprietary trading from retail banking, as proposed by some members of Congress⁴) to other forms of restructuring banks with the aim of restricting government guarantees to utility banking (as suggested by Mervyn King, Governor, Bank of England).⁵ In a similar vein, Lord Turner, Chairman of the UK Financial Services Authority (FSA), has proposed that perhaps banks need to shrink, simplify their structures and get less profitable in the public interest.⁶ He had earlier suggested the imposition of a tax on FI transactions as an option for "stop[ping] excessive pay in a swollen financial sector."⁷

It is beyond the scope of this *ViewPoints*⁸ to examine these crucial public policy issues that sprout from, or at least intersect with, concern over high banker pay. Nor did the discussion on compensation at the October 5 and 6, 2009 Financial Institution Directors Summit,⁹ or the extensive body of research developed in its preparation,¹⁰ explore these policy issues in any detail. We cite them here as a reminder that bank compensation decisions must be carefully considered in a broad context. See “About this document” (page 13) for more on the research and “FI Directors Summit participants” for a list of attendees.

Key takeaways from the summit discussion are covered in three sections of this *ViewPoints*:

- **Changes to FI compensation structure and oversight are well under way** (*page 2*)

Summit participants noted that FI boards have been proactively working to change their firms’ pay practices. Banks have adopted new structures to better link pay with risk- and capital-adjusted performance. Board oversight has been strengthened, with compensation committees stress-testing potential, and retaining more discretion over actual, payouts. Risk professionals are also being drawn into evaluating the risk dimensions of pay.

- **The public debate over absolute levels of banker pay obscures complex issues** (*page 7*)

The financial crisis has triggered considerable public anger over the levels of FI compensation. Politicians initially responded with calls to cap pay, but have since relented, and now most intend only to regulate pay structures. Summit participants acknowledged that in some instances, FI compensation has been too high, but they emphasized that it is an extremely complex issue that depends on a variety of factors, including each bank’s mix of businesses, the mobility of top-performing talent, and the ways in which individual companies allocate profit.

- **External stakeholders could have a major influence over the future of FI compensation** (*page 10*)

Summit participants highlighted that in the future, key external stakeholders could have a major effect on future pay practices and levels. They are concerned that regulatory involvement will be too detailed and uneven across borders and worry that more investor influence will have unintended consequences. They predicted that 2009 year-end compensation payouts, however much they are merited based on firm performance, may inflame public and political outrage even further.

Changes to FI compensation structure and oversight are well under way

Research and summit participants stressed that FI directors¹¹ are not simply watching the political debate unfold on compensation. Board leaders are taking a proactive approach to assessing and, where necessary, adapting pay and related practices to reduce the likelihood that pay creates excessive risks.

They outlined five specific ways in which FI boards have been addressing compensation:

1. Ensuring a robust risk management approach is in place
2. Appropriately capital-charging business and bonus pools
3. Implementing an array of new pay practices
4. Improving board and committee oversight of pay
5. Incorporating the views of the risk management organization

Ensuring a robust risk management approach is in place

Summit participants agreed that a strong risk management structure and culture is crucial to ensuring that employees at FIs are not incentivized to take excessive risks. As one put it, “[*The structure [of pay] has to be more aligned with risk management.*” A strong risk management structure includes an independent chief risk officer (CRO) who reports routinely to the board or its key committees, a well-defined board risk oversight mechanism, and a culture of challenge at the board level. Also important is active, cross-committee engagement and firm-wide awareness of how individual decisions may impact the enterprise at large.

A firm’s approach to compensation must also not undermine its risk control processes. As the Basel Committee on Banking Supervision put it, “For a broad and deep risk management culture to develop and be maintained over time, compensation policies must not be unduly linked to short-term accounting profit generation.”¹² Risk oversight was a critical focus of summit discussions and is covered in more detail in “Risk governance in a new era.”¹³

Appropriately capital-charging business and bonus pools

Throughout the summit, participants stressed that FIs have more work to do on properly charging their business units for the capital they use to generate returns. Most agreed with one director’s view that, while improvements have been made, banks “*need to spend more time getting the capital charge right.*” Participants observed that ineffective capital charging has a direct effect on compensation. As one noted, “*Compensation-fueled behavior contributed to the crisis; that behavior was made possible in part by a loose allocation of capital.*” Another said, “*We are trying to get the capital charge right, so [employees] aren’t trading on our capital.*”

Prior to the summit, one director expressed a similar view: “High pay is a by-product of too much leveraged equity, too much capital at risk, and not enough capital being held. These factors meant we had artificially high profits, and as a result we could pay out more.” That director continued, “I don’t mind if compensation [is] based on ... higher returns. But ... not [when] ... people are incentivized to misprice risk or empowered to take risks without a counterweight ... They need to get a capital charge for that additional risk.” At the summit, Credit Suisse CEO Brady Dougan suggested FIs should allocate bonus pools “*based on risk-adjusted capital returns. The more capital-intensive your business model, the more you are going to charge.*”

Implementing an array of new pay practices

There is strong political support for the *Principles for Sound Compensation Practices*,¹⁴ published by the Financial Stability Forum, or FSF (since reconstituted as the Financial Stability Board, or FSB) at the two G-20 meetings in April and September 2009. Individual regulators have been charged with implementing the principles in their own jurisdictions. The final rules of the FSA are closely aligned with the FSF/FSB principles, and the somewhat abbreviated version of the FSA's principles presented below helps illustrate the broad thrust of the FSB's recommendations:¹⁵

- These structures apply to any person who performs a significant-influence function for the firm or who could have a material impact on the firm's risk profile.
- The structure of compensation should be consistent with and promote effective risk management.
- The fixed portion of compensation should be a sufficient proportion of total compensation to allow a firm to operate a flexible bonus policy – including no bonus at all in a year when the firm made a loss.
- A significant proportion (at least two-thirds) of any bonus should be deferred, with a minimum vesting period of at least three years.
- A significant proportion of variable compensation (bonus) should be linked to the future performance of the firm and the person's own business within the firm.
- Compensation paid in shares should be based on risk-adjusted performance measures.
- Compensation paid in cash should also be subject to performance criteria.
- Bonus pools and individual bonuses should be based on employee, division, business unit, or firm performance during the period under review. They should also be linked to the future performance of the business unit and firm.
- Guaranteed minimum bonuses for a period of more than one year not based on performance during that period are likely to be inconsistent with the FSA's principles.

Pay approaches announced earlier this year by Goldman Sachs¹⁶ and UBS¹⁷ are broadly consistent with these principles. Mr. Dougan noted at the summit, "*The G-20 schemes are healthy and seem right to adopt;*" subsequently, Credit Suisse announced a set of changes to its 2009 compensation approach for a large number of top earners, including changing the mix of base salary to bonus, tying incentive payouts to specific financial metrics, and incorporating clawback provisions.¹⁸

Political and regulatory pressure on global banks to implement G-20 recommendations is growing. Just before the summit, the UK's five largest banks agreed to adopt recommendations from G-20 rules and to:

have an independent committee submit annual compensation reports to the U.K.'s Financial Services Authority. In addition, they say senior executives and employees who manage risk

must defer 40% to 60% of compensation over three years, and at least 50% should be in shares. There is also a requirement that poor performance should lead to a return of a person's bonus. Banks could be subject to additional capital requirements if they don't comply with the standards.¹⁹

Shortly after the summit, the UK subsidiaries of leading foreign banks, including Bank of America, Merrill Lynch, Citigroup, Credit Suisse, Goldman Sachs International, JP Morgan Securities Ltd., Morgan Stanley, Nomura, and UBS also agreed to the principles.²⁰

Research and summit participants highlighted a number of changes FI boards are putting in place to be consistent with the FSF/FSB principles.

Changes FI boards are implementing in light of the FSF/FSB principles

- **Retaining more discretion in payout.** Even after ensuring pay decisions are appropriately risk- and capital-adjusted, compensation committees are retaining more discretion to override formulaic pay, if necessary. One summit participant noted that *"[our] committee has the option to move pay up or down ... based on risk. Normally it would be an adjustment of plus or minus 20%, but [we] have the right to take it to zero."*
- **Stress-testing payouts.** As one summit participant noted, *"We made some projections for shareholder value based on history, picked a mix of compensation, and stressed it up and down ... You have to tie compensation as close to shareholder value as you can over the long term."*
- **Moving to longer vesting periods.** "Employees need more skin in the game, over longer periods," said one research participant prior to the summit. Companies are lengthening the vesting time frames of various forms of compensation, including cash equivalents, options, stock, and restricted stock units.
- **Increasing deferred compensation.** Several directors stated prior to the summit that they believed that "three-year deferral could become the norm." FI leaders whose firms do not already have deferrals in place reported that they are working on or considering plans to do so. Firms that currently use deferred compensation are lengthening deferral periods and/or increasing the percentage of pay subject to deferral.
- **Incorporating risk-weighted metrics.** Some companies are linking bonus payouts to measures such as weighted-average loss ratings of loan portfolios. As one director noted before the summit, *"We can show that we're thinking about it and making linkages [between risk metrics and compensation]."*

continued on overleaf

Changes FI boards are implementing in light of the FSF/FSB principles (*continued*)

- **Instituting clawbacks.** Most summit participants agreed with Mr. Dougan’s statement that *“having broader clawback is healthy.”* One director criticized the current concept of clawback as *“too narrow. Legal clawback has no teeth.”* A participant in the pre-summit conversations said, *“We need clawback provisions, not just tied to fraud, but tied to future years’ performance, if the trading book loses value.”* In practice, FIs are holding some portion of each individual’s earned pay, with the option to keep it or pay it out, depending on future years’ performance.
- **Increasing base salary.** Some companies are increasing salary levels and/or the percentage of fixed compensation vis-à-vis variable compensation.

Improving board and committee oversight of pay

Many of the summit participants said that their compensation committees are spending more time on pay matters. One noted, *“This summer, we had four extra committee meetings and changed our compensation structures.”* Board leaders reported that their compensation committees are considering two methods for improving board-level oversight of pay:

- **Going deeper into the ranks.** During our research, there was general agreement that compensation committees now have to look more broadly at pay within their firms; a focus solely on top executives is no longer sufficient. When the issue was discussed prior to the summit, views varied as to how deep to go:
 - Some said the committee should review the pay packages of the 100 highest-paid employees.
 - Others argued the committee should review “anyone who takes risk at a level which impacts the firm.”
 - Others said the committee should “just look at the overall philosophy. If the board has to decide on compensation plans, it’s too late; the [senior] management team should have resolved the issue already.”
- **Coordinating better with other committees.** The compensation committee must now work much more closely with other committees and with the full board. Certainly, the risk committee has stepped up its involvement, as have audit committees.

Incorporating the views of the risk management organization

Summit participants said that FI boards cannot take on the task of conforming to structural guidelines on their own. They are now involving the risk organization in compensation matters, and particularly the CRO. For many FIs, this is the first year that risk professionals have been formally called upon to evaluate and comment on – and in some cases, attest to – the riskiness of pay structures. Summit participants spoke about executives’ increased involvement in

compensation planning. One participant said, *“Our CRO will be coming to compensation committee meetings twice a year with a full report on whether earnings reflect the risk appetite.”*

However, our discussions with risk professionals prior to the summit suggest that they do not want to get drawn too deeply into pay matters. They agree with summit participants that the most effective approach is to ensure risk management processes are robust and that effective mechanisms for capital-charging businesses and bonus pools are in place. Few had a clear view on how they would certify that all their firm’s actual pay practices do not encourage undue risk taking. They noted that FIs can have hundreds, even thousands, of distinct pay plans, and consequently they are unsure if they should sample individual programs across the firm or examine them all.

In any case, there was strong agreement that central oversight responsibility for pay should remain firmly with the compensation committee, even if the CRO becomes more involved. Noted one research participant prior to the summit, *“The CRO and risk committee can comment on the methodology and help validate the assumptions behind the numbers, but it’s not [their] role to decide what the compensation scheme should be, or to approve it.”*

The public debate over absolute levels of banker pay obscures complex issues

Politicians on both sides of the Atlantic have expressed sympathy for the widespread public sentiment that banker pay is excessive. Political leaders have consistently identified banker compensation as one of many causes of the financial meltdown (although few rank it as a primary factor). Some initially expressed a desire to cap pay, though most have since backed away from that stance. For their part, summit participants conceded that, in some instances, pay may have been too high, but said the public debate has been conducted in a way that greatly understates the complexities of FI compensation.

The political debate has centered on curbing “excessive pay”

The political debate about compensation has evolved during the past 12 months and intensified considerably during the two G-20 meetings this year, in April and September. Initially, the energy to address pay emanated from the United States and the UK, in the run-up to the April G-20 meeting in London. In February, President Obama asserted, *“What gets people upset – and rightfully so – are executives being rewarded for failure. Especially when those rewards are subsidized by U.S. taxpayers.”*²¹ In the same month, the UK’s FSA issued its consultative paper on compensation, promising tougher regulatory intervention.

Since then, however, the discussion on pay has evolved significantly. Politicians and regulators in the UK and the US have pulled back from pay matters, to some degree, with the exception being institutions that have received and still retain sizeable government subsidies. (On October 22, Kenneth Feinberg, the US Treasury’s “pay czar,” announced the decision to cap salaries and limit total pay at banks and other companies receiving significant government funding.²²) For all other FIs, President Obama has reasoned that shareholders, not government, should determine compensation levels,²³ via an advisory vote on pay (say on pay)²⁴ and with improved pay disclosure requirements from the Securities and Exchange Commission (SEC). The FSA has also backed

away from strong intervention on pay matters; its revised pay principles, issued in August, were less aggressive than expected.²⁵

Meanwhile, European politicians have become more vocal on the need to intervene in pay matters, with some forcefully arguing in favor of imposing caps on compensation and taxing bonuses.²⁶ In September, Britain's Prime Minister Gordon Brown, Germany's Chancellor Angela Merkel, and President Nicolas Sarkozy of France sent a letter to Fredrik Reinfeldt, Sweden's prime minister and current chair of the EU, in which they argued for a cap on bonuses: "We should explore ways to limit total variable remuneration in a bank either to a certain proportion of total compensation or the bank's revenues and/or profits."²⁷ Mr. Sarkozy proposed that regulators be given the authority to cap banker pay, arguing, "A bank (making a profit) should retain an important part of it, as it will enable it to increase lending to households and companies. Supervisors have to be given the power to cap bonuses in relation to a bank's revenues."²⁸

However, despite this pressure, G-20 leaders repeated their endorsement for the FSB's pay principles and avoided detailed rules or caps on pay at their September 2009 meeting.²⁹ For their part, regulators have said that capping pay is not their responsibility. For example, Hector Sants, the FSA's CEO, stated, "Often conflated with the issue of the incentives created by the remuneration policies is whether large individual awards are somehow inherently immoral. This is not a question that the Financial Services Market Act (FSMA) requires the FSA to answer, nor in my view is it one that any regulator should be seeking to address."³⁰

Bank directors recognize the problem, but highlight the complexities ignored by politicians

Many summit participants acknowledged that the "*quantum of pay*" has, in some instances, been too high. One board leader stated bluntly, "*Compensation is too high and leads to excessive risk taking.*" Several leading FI CEOs agree. Lloyd Blankfein, chairman and CEO of Goldman Sachs, said in September, "Compensation continues to generate controversy and anger. And, in many respects, much of it is understandable and appropriate. There is little justification for the payment of outsized discretionary compensation when a financial institution lost money for the year."³¹

Royal Bank of Scotland chief Stephen Hester told the UK Treasury Select Committee in February that, in some cases, banker pay was "way too high."³²

Summit participants noted two factors that may be pushing pay levels too high:

- **Overpaying the middle 80%.** Many participants agreed with one director's view that "*the issue is not paying the top talent. It's paying the middle ... that didn't earn [high] bonuses. The issue is whether we are significantly overpaying the middle 80% of the bell curve, and I think we have been.*" Addressing that issue could greatly reduce each firm's cost base and defuse some of the public anger.
- **Excessive dependence on lateral hires.** Mr. Dougan pondered the effect of changing the manner in which FIs deal with filling open positions. He noted that a high percentage of replacements are hired from other firms, with the remainder hired from university campuses. He speculated that rebalancing that ratio "*would [not only] change the cost base, it would be a*

huge shift in culture, and a real way to create value. Managers would have to invest more time to develop people.”

However, overall, summit participants believe serious debate on pay levels requires careful consideration of a range of complex and interrelated factors. They noted a number of issues that need to be taken into account:

- **A mobile talent pool makes compensation a cross-border issue.** Summit participants discussed how the cross-border dimension of the war for top talent is a major driver of pay. They agreed with one participant who pointed out that the highly mobile talent market dictates banker pay: *“The whole debate over compensation is interesting, but not useful. Regulators will back down. Sarkozy will change his mind once French banks become non-competitive. When banks start losing business, regulators will change their minds in five minutes.”* Prior to the summit, several research participants pointed out that the locus of business operations can also be shifted. As one director put it, “Politicians’ brave words and chest thumping [about compensation] will come back to haunt them ... when push comes to shove, and banks start moving their head offices.”
- **The real war for top talent is between banks and unregulated hedge funds.** Summit participants observed that politicians routinely forget that FIs also compete with unregulated entities for talent. Several participants said pay caps on banks could trigger a migration of talent to hedge funds. *“If compensation is regulated, these guys will just go to the shadow markets. Their solution is to chase the hedge funds.”* While one participant argued that perhaps hedge funds *“could not absorb the amount of people leaving banks,”* another said, *“That’s true, but it’s only the top performers who leave. It’s a fight for [top] talent, not volume. If we get into a battle for compensation with hedge funds, we can’t win. We’ll lose our best people.”*
- **Global pay levels are influenced by a small number of FIs.** Politicians rarely distinguish one FI from another in the context of pay. By contrast, summit participants highlighted that the majority of banks do not engage in significant capital markets activities and therefore do not need to compete for the highest-paid talent. *“In reality, this is about the major firms operating in the capital markets business. There are four or five firms that matter in terms of pay,”* noted one participant. Another said, *“When you are not in New York and don’t have a trading floor, you don’t have this set of issues.”* Yet, as one director pointed out, the entire banking industry has been tarnished by the compensation issue. Summit participants noted that strong earning-and-profit results for a number of large investment banks, which seem to point to high 2009 bonus payouts at these firms, will continue to fuel public anger at the industry as a whole.
- **Pay levels are symptomatic of the broader issue of the allocation of profits.** Thoughtful commentators have highlighted that high pay is a symptom of the profit-generating capacity of the industry and have suggested that should be discussed prior to considering caps on pay. For example, Lord Adair Turner, the FSA chairman, noted,

If you want to stop excessive pay in a swollen financial sector you have to reduce the size of that sector or apply special taxes to its pre-compensation profit. Higher capital requirements against trading activities will be our most powerful tool to eliminate

excessive activity and profits. And if increased capital requirements are insufficient I am happy to consider taxes on financial transactions. The problem is that getting global agreement will be very difficult ... Insisting that someone 'does something' about bonuses, by contrast, is a populist diversion.³³

Summit participants agreed that the allocation of profits is the broader issue that deserves public discussion. They expressed concern about indications that politicians, searching for ways to restrict compensation, may take steps to limit bank profits or force banks to reduce or sell off their trading operations. Participants dismissed the notion of blanket regulation as unhelpful, given that each bank has different responsibilities to different stakeholders. One participant pointed out that not all banks distribute profit equally and suggested that restricting compensation at government-owned banks would only widen the competitive gap in the industry. *"We should have a thoughtful debate about how we should divide up compensation. [Investment banks] don't pay their shareholders, they pay their employees. Some FIs now have three mouths to feed: the government/taxpayer, employees, and shareholders."*

- **Clamping down on bank pay will likely have negative unintended consequences.** Summit participants worry that in addition to pushing talent out into hedge funds or pushing firms to redomicile in other countries, political pressures on pay will have other unintended consequences that are not good for the individual firms or capital markets at large. An example may be the decision a week after the summit by Citigroup, which is 34% owned by the government, to sell its highly profitable energy trading outfit, Phibro, for "slightly more than book value" to Occidental Petroleum.³⁴ Arguably, Citigroup sold Phibro, despite its having brought in earnings of over \$2 billion in the last five years, because of public pressure on the firm to renege on its contractual commitment to pay Phibro's top trader a reported \$100 million bonus.³⁵ Prior to the summit, one participant articulated the view of many that it was worth paying top dollar to retain high-performing talent: "As a taxpayer, I want these firms to have the best talent so that they can pay us back."

External stakeholders could have a major influence over the future of FI compensation

FI boards are addressing pay issues with increased diligence, but directors recognize that in substantive ways, the future of FI compensation will depend on the actions of external parties as well as boards. Specifically, members said that regulators, shareholders, and the public will help shape compensation structures at FIs in potentially significant ways.

Regulatory influence

Summit participants expressed concern that regulators may get drawn too deeply into pay decisions. As one participant put it, *"There's a concern that regulators will take principles – the model is the FSB principles – and turn them into specific, black-and-white rules."* At the summit, directors said they were closely following the various reform proposals aimed at restricting pay plans that encourage risk taking, including mandated deferrals, clawback mechanisms, and requirements regarding how much capital banks set aside against certain risks.

Bill Rutledge, who is the executive vice president of the Bank Supervision Group of the Federal Reserve Bank of New York, addressed this issue: *“The Fed will soon be offering guidance focusing on incentive structures for individual firms.”* In terms of ensuring regulators have the skills necessary to review pay, he noted, *“We will be reaching out to internal risk management experts and HR professionals ... to tap resources to do micro supervision effectively.”* In late October, the Federal Reserve Board issued proposed guidance on compensation and announced two supervisory initiatives designed to “spur and monitor the industry’s progress towards the implementation of safe and sound incentive compensation arrangements,” including a detailed review of pay practices at a number of “large, complex banking organizations.”³⁶

Summit participants wondered how much further detailed regulatory involvement would go, particularly in light of statements from key influencers like the SSG that “Supervisors are concerned about the durability of [FIs’] proposed [compensation] changes,”³⁷ and in the context of threats of additional capital requirements for firms deemed to have “risky pay.” As one participant noted, *“There’s a paragraph in the FSA document [on pay] that has the potential for material regulatory interference on capital adequacy.”*

Participants were even more concerned about a lack of cross-border coordination when it comes to implementing new pay principles. As one director noted, *“At the end of the day, it isn’t the process; we know how to change it. It’s how to make sure it is consistent across all regulatory bodies.”* Another said, *“Everybody understands there is a need for greater regulatory scrutiny in the industry. What we fear like hell is the way it might actually play out in the field – with regulators going in all different directions.”* Another participant agreed: *“[Cooperation] moves very slowly. Regulators become totally nationalistic.”* Mr. Dougan noted that *“a big challenge is [regulatory] coordination across different jurisdictions and potential policies being uneven across borders.”*

Both Mr. Rutledge and Sally Dewar, the managing director for risk at the FSA, acknowledged FIs’ concerns about the need for regulatory coordination. Ms. Dewar noted, *“There should be an international global response with key regulators ... engaging with higher-impact firms. We need to work with common aims, work with the home host model.”* In this context, one participant said that in talking to his firm’s regulators, he has made clear to them that *“they need to go and talk to other regulators and ensure there is consistency – otherwise, I’ve violated my fiduciary duty to our shareholders [by not offering competitive compensation].”*

Shareholder influence

Summit participants suggested that shareholders may also have a significant impact on FI compensation, particularly given that they are being urged by politicians to play a much more active role in this regard.³⁸ Politicians and regulators have sought to arm shareholders with more power in dealing with FI boards. Advisory votes on executive compensation (say on pay) are being considered in the United States, and UK regulators are actively encouraging more substantive dialogue between board directors and investors.³⁹

Summit participants believe that shareholders' involvement in setting pay could have a number of significant effects beyond banker compensation itself. One participant said, *"I would expect to see say on pay, as well as contested director elections. Inevitably, they will target financial institutions. I expect to see directors stand down from FI boards."* Another predicted, *"Say on pay will have big unintended consequences – I don't think this is appreciated enough. Due to cultural differences, it will play out very differently in the US versus the UK versus Europe. In general, it will force more dialogue between investors and companies. There will be turbulence in the early years of say on pay."* Some research participants noted prior to the summit that, in the past, investors pushed for pay for performance and heavy use of stock options. In the aftermath of the financial crisis, they rue the fact FIs implemented their demands.

One participant said say-on-pay requirements will provide boards with an opportunity to establish better relationships with influential shareholders. *"I asked a big institutional investor recently, 'Do you have a plan for how you'll carry out evaluations if say on pay passes?' Most of them don't have the resources or capability to do so, but we can begin to deal with it if we can get a dialogue going with shareholders earlier than when the [Compensation Discussion & Analysis in the proxy statement] comes out. We have an opportunity to get them on our side."*

Public influence

Summit participants spent time talking about the industry's need to regain the trust of its key stakeholders. For more on this topic, see *"Restoring trust: lofty expectations for post-crisis bank boards."*⁴⁰ Summit participants recognize that year-end 2009 compensation decisions will have significant impact on the direction of the public debate. They already foresee that some firms will have to make some challenging decisions because firms' profits will likely be significantly more favorable than anyone expected in the first half of 2009. A *Wall Street Journal* survey published after the summit found that *"total compensation and benefits at the publicly traded firms analyzed by the Journal are on track to increase 20% from last year's \$117 billion – and to top 2007's \$130 billion payout."*⁴¹ At the summit, most participants agreed with one director's view that *"producers will continue to get paid a lot – and 'a lot' will be somewhat less than it was in 2007."*

The media attention on year-end payouts has been growing materially, with several noteworthy figures calling FIs to rein in pay. Even some regulators have been drawn into the debate. Mr. Sants noted,

There is this wider question as to whether, given banks are arguably still in receipt of some form of underpinning, soft guarantee, they should recognize this in their bonus policies ... personally, I think they should recognize their wider responsibility to society. They should recognize what has happened in the last few years and they should recognize that without the interventions made by government and taxpayers around the world, the situation they would be in now would be far worse ... I think it would be reasonable for them to take that into account as they go into their bonus rounds.⁴²

Ultimately, as one participant noted, “[*The public and their elected officials*] need a demon, and it is easier to demonize someone who took a lot of money. Which is easier [for the public] to demonize ... compensation, broad public policy, or bad capital allocation?”

Conclusion

Summit participants acknowledged that, to some extent, compensation policies played a role in the financial crisis, and they understand the public anger over large payouts. They noted that regulators are primarily focused on reforming the structure of bank pay, ensuring capital has been properly assigned in order to risk-adjust profits, and improving the links between the governance of compensation and risk. On these issues, substantive progress has been made in setting policy, by banks themselves as well as by regulators. Board leaders highlighted a range of actions FIs are taking to address pay, including instituting improved risk management practices, more effective capital charges across business, and longer-term pay structures.

Meanwhile, politicians, institutional investors, the press, and the public are focused on the absolute levels of banker compensation and are asking questions about what kind of banking sector would serve society best. At the summit, directors stressed that the problems with FI compensation cannot be fixed by simply putting limits on pay levels, because many factors influence compensation, including the bank’s lines of business, the allocation of profits, and competition for highly mobile talent.

Summit participants recognized that because the board’s oversight of pay matters does not happen in a vacuum, board leaders need to respond to both sets of concerns. The actions of regulators, shareholders, policymakers, and the general public will have some degree of influence over the future of FI compensation.

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.

The perspectives presented in ViewPoints are the sole responsibility of Tapestry Networks and do not necessarily reflect the views of any individual FI, its directors or executives, or Ernst & Young. Please consult your counselors for specific advice. Ernst & Young refers to all members of the global Ernst & Young organization. The copyrights on this material are jointly held by Tapestry Networks and Ernst & Young. ViewPoints may be reproduced and redistributed, but only with attribution. If reproduced substantially or in its entirety, it should include all copyright and trademark legends.

Endnotes

- ¹ 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.
- ² "Compensation" and "remuneration" are used interchangeably throughout this document.
- ³ "Goldman profit quadruples; bonus reserve lower," Reuters, October 15, 2009. Available at <http://news.moneycentral.msn.com/ticker/article.aspx?Feed=OBR&Date=20091015&ID=10494797&Symbol=MS>.
- ⁴ John Cornyn, Lloyd Doggett, Kay Bailey Hutchinson, "Reinstate Glass-Steagall," Letter to President Barack Obama, September 16, 2009. Available at http://www.congress.org/congressorg/bio/userletter/?id=31770&letter_id=3946442376.
- ⁵ Mervyn King, remarks to Scottish business organizations, Edinburgh, October 20, 2009. Available at <http://www.bankofengland.co.uk/publications/speeches/2009/speech406.pdf>.
- ⁶ Adair Turner, "Large systemically important banks: addressing the too-big-to-fail problem," speech at the Turner Review Conference, November 2, 2009. Available at http://www.fsa.gov.uk/pages/Library/Communication/Speeches/2009/1102_at.shtml.
- ⁷ Phillip Inman, "Financial Services Authority chairman backs tax on 'socially useless' banks," *The Guardian*, August 27, 2009. Available at <http://www.guardian.co.uk/business/2009/aug/27/fsa-bonus-city-banks-tax>.
- ⁸ 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.
- ⁹ 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.
- ¹⁰ 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.
- ¹¹ In this document, "director" refers to non-executive, non-employee board members on a firm's unitary or supervisory board.
- ¹² Basel Committee on Banking Supervision, *Proposed enhancements to the Basel II Framework* (Basel: Basel Committee on Banking Supervision, 2009), 25. Available at <http://www.bis.org/publ/bcbs157.pdf?noframes=1>.
- ¹³ Tapestry Networks, "Risk governance in a new era," *ViewPoints*, November 2009. Available at http://www.tapestrynetworks.com/documents/Tapestry_EY_BGLN_Nov09_View2.pdf.
- ¹⁴ Financial Stability Forum, *FSF Principles for Sound Compensation Practices* (Basel: Financial Stability Forum, 2009). Available at http://www.financialstabilityboard.org/publications/r_0904b.pdf.
- ¹⁵ Financial Services Authority, *Reforming compensation practices in financial services: Feedback on CP09/10 and final rules* (London: Financial Services Authority, 2009), Annex B, 11–12. Available at http://www.fsa.gov.uk/pubs/policy/ps09_15.pdf.
- ¹⁶ Goldman Sachs, "Goldman Sachs' Compensation Principles," <http://www2.goldmansachs.com/our-firm/investors/corporate-governance/corporate-governance-documents/compensation-doc.pdf>.
- ¹⁷ UBS, "Compensation principles 2009 and beyond for UBS senior executives," http://www.ubs.com/1/e/investors/annual_reporting2008/cgr2008/0017.html.
- ¹⁸ Graham Bowley, "Credit Suisse Overhauls Compensation," *New York Times*, October 21, 2009. Available at <http://www.nytimes.com/2009/10/21/business/global/21pay.html>. Also see "Credit Suisse announces its compensation structure for 2009 and 2010," press release, October 20, 2009. Available at https://www.credit-suisse.com/news/en/media_release.jsp?ns=41331.
- ¹⁹ Sara Schaefer Muñoz, "U.K.'s Top Banks Agree to Bonus Curbs," *Wall Street Journal*, October 1, 2009. Available at <http://online.wsj.com/article/SB125432815717053019.html>.
- ²⁰ HM Treasury, "City of London banks agree to support G20 bonus reforms," press release, October 14, 2009. Available at http://www.hm-treasury.gov.uk/press_92_09.htm.
- ²¹ Jim Kuhnhehn, "Obama Imposes Pay Cap on Executives," AP newswire, February 4, 2009. Available at <http://news.aol.com/main/obama-presidency/article/obama-pay-cap-executives/328268>.
- ²² Aaron Lucchetti, David Enrich, and Joann S. Lublin, "Fed Hits Banks With Sweeping Pay Limits," *Wall Street Journal*, October 23, 2009. Available at http://online.wsj.com/article/SB125623026446601619.html?mod=WSJ_hps_LEFTWhatsNews.
- ²³ Kevin Hechtkopf, "Obama: Transparency and Accountability for Executive Salaries," *Political HotSheet*, April 2, 2009. Available at <http://www.cbsnews.com/blogs/2009/04/02/politics/politicalhotsheet/entry4914280.shtml>.

- ²⁴ House Resolution 3269, the Corporate and Financial Institution Compensation Fairness Act of 2009, would provide shareholders with a say on pay and require appropriate regulators to prescribe regulations that prohibit any compensation structure or incentive-based payment arrangement that encourages inappropriate risks.
- ²⁵ Caroline Binham, "FSA Rules Seek to Rein In Risky Bonuses at U.K. Banks," *Bloomberg.com*, August 12, 2009. Available at <http://www.bloomberg.com/apps/news?pid=20601208&sid=a17Ur.K0pOus>.
- ²⁶ See, for example, "German BaFin Clamps Down On Bank Risk Management, Bonuses," *Dow Jones Deutschland*, August 14, 2009, (available at <http://www.dowjones.de/site/2009/08/german-bafin-clamps-down-on-bank-risk-management-bonuses-.html>), Ben Hall, "French banks warned to curb bonuses," *Financial Times*, August 6, 2009 (available at <http://www.ft.com/cms/s/0/6a49f632-8293-11de-ab4a-00144feabdc0.html>), and "Cap City wages and tax bonuses at 90 per cent, Alistair Darling is urged," *Daily Mail*, August 17, 2009 (available at <http://www.dailymail.co.uk/news/article-1206878/Cap-City-wages-tax-bonuses-90-cent-Alistair-Darling-urged.html>).
- ²⁷ Gordon Brown, Angela Merkel, Nicolas Sarkozy, "Verbatim Text Of Sarkozy, Merkel, Brown Letter On G20," *Wall Street Journal*, September 3, 2009. Available at <http://online.wsj.com/article/BT-CO-20090903-705967.html>.
- ²⁸ Nathalie Boschat, "France's Sarkozy Urges G-20 to Cap Bankers' Bonuses," Dow Jones newswires, September 25, 2009. Available at http://news.morningstar.com/newsnet/ViewNews.aspx?article=/DJ/200909251515DOWJONESDJONLINE000551_univ.xml.
- ²⁹ Christine Harper and Ian Katz, "G-20 Leaders Resist Caps in Adopting Compensation Guidelines," *Bloomberg.com*, September 26, 2009. Available at <http://www.bloomberg.com/apps/news?pid=20601081&sid=a3o9nf4Y2eWk>.
- ³⁰ Hector Sants, "Pay what you like, but within your means," *Financial Times*, August 11, 2009. Available at <http://www.ft.com/cms/s/0/89367958-86b7-11de-9e8e-00144feabdc0.html>.
- ³¹ Lloyd Blankfein, remarks at Handelsblatt Banking Conference, September 9, 2009. Available at <http://www2.goldmansachs.com/ideas/public-policy/1-compensation/lcb-handelsblatt-remarks.html>.
- ³² Abigail Townsend, "RBS Chief Stephen Hester to overhaul pay structure," *Telegraph*, February 12, 2009. Available at <http://www.telegraph.co.uk/finance/newsbysector/banksandfinance/4594475/RBS-chief-Stephen-Hester-to-overhaul-pay-structure.html>.
- ³³ Adair Turner, "How to tame global finance," *Prospect*, August 27, 2009. Available to subscribers at <http://www.prospectmagazine.co.uk/2009/08/how-to-tame-global-finance/>.
- ³⁴ Eric Dash and Jack Healy, "Citigroup Sheds Andrew Hall, its \$100 million man," *New York Times*, October 9, 2009. Available at http://www.nytimes.com/2009/10/10/business/10citi.html?_r=1&adxnml=1&adxnml=1255522609-BvOQxahzqt1SjQLGIS9jxw.
- ³⁵ *Ibid.*
- ³⁶ Board of Governors of the Federal Reserve System, "Proposed Guidance on Sound Incentive Compensation Policies," *Federal Register*, October 27, 2009. Available at <http://edocket.access.gpo.gov/2009/pdf/E9-25766.pdf>.
- ³⁷ Senior Supervisors Group, *Risk Management Lessons from the Global Banking Crisis of 2008* (Senior Supervisors Group, 2009), 24. Available at http://www.newyorkfed.org/newsevents/news/banking/2009/SSG_report.pdf.
- ³⁸ The Walker Report (*A review of corporate governance in UK banks and other financial industry entities*), the FSA policy statement, and HR 3269 all stress shareholder involvement.
- ³⁹ As discussed earlier, HR 3269 includes a provision for say on pay, while thirteen of Canada's largest companies have voluntarily adopted say on pay provisions. See Andrea Hopkins, "Big Canada companies sign up for votes on exec pay," *Yahoo Finance News*, October 26, 2009. Available at <http://ca.news.finance.yahoo.com/s/26102009/6/finance-big-canada-companies-sign-votes-exec-pay.html>. The Walker Review encourages more substantive dialogue between directors and investors.
- ⁴⁰ Tapestry Networks, "Restoring trust: lofty expectations for post-crisis bank boards," *ViewPoints*, November 2009. Available at http://www.tapestrynetworks.com/documents/Tapestry_EY_BGLN_Nov09_View1.pdf.
- ⁴¹ Aaron Lucchetti and Stephen Grocer, "Wall Street On Track To Award Record Pay," *Wall Street Journal*, October 14, 2009. Available at <http://online.wsj.com/article/SB125547830510183749.html#printMode>.
- ⁴² "British regulatory chief warns on bank bonuses," *New York Times*, October 19, 2009. Available at <http://dealbook.blogs.nytimes.com/2009/10/19/fsa-chief-warns-on-bank-bonuses/>.

Building a high-impact, effective board¹

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 directors² attending the Financial Institution Directors Summit,³ 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*,⁴ 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*⁵ 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.⁶ 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.”⁷

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.⁸ 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.”*⁹
- **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.¹⁰

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."¹¹ 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.”¹² 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.¹³ 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.’”¹⁴ 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].”¹⁵

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.¹⁶ 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.¹⁷ 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.”¹⁸

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.¹⁹

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,²⁰ 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 UK²¹ and the Netherlands²² 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.”*²³

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.

The perspectives presented in ViewPoints are the sole responsibility of Tapestry Networks and do not necessarily reflect the views of any individual FI, its directors or executives, or Ernst & Young. Please consult your counselors for specific advice. Ernst & Young refers to all members of the global Ernst & Young organization. The copyrights on this material are jointly held by Tapestry Networks and Ernst & Young. ViewPoints may be reproduced and redistributed, but only with attribution. If reproduced substantially or in its entirety, it should include all copyright and trademark legends.

Endnotes

- ¹ 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.
- ² In this document, "director" refers to non-executive, non-employee board members on a firm's unitary or supervisory board.
- ³ 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.
- ⁴ 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.
- ⁵ 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.
- ⁶ 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.
- ⁷ 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.
- ⁸ 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.
- ⁹ Tapestry Networks, *Shaping bank governance in a new era: A revised compact with management and shareholders* (Waltham, MA: Tapestry Networks, 2009), 11.
- ¹⁰ 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>.
- ¹¹ David Walker, *A review of Corporate Governance in UK Banks and Other Financial Industry Entities*, 6, 10.
- ¹² Tapestry Networks, *Shaping bank governance in a new era: Enhanced oversight versus radical reform* (Waltham, MA: Tapestry Networks, 2009), 11.
- ¹³ *Ibid.*
- ¹⁴ 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.
- ¹⁵ David Walker, *A review of corporate governance in UK banks and other financial industry entities*, 10.
- ¹⁶ 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.
- ¹⁷ 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>).
- ¹⁸ Treasury Committee of the House of Commons, "Corporate governance," <http://www.publications.parliament.uk/pa/cm200809/cmselect/cmtreasy/519/51907.htm#a24>.
- ¹⁹ Tapestry Networks, *Risk governance in a new era* (Waltham, MA: Tapestry Networks, 2009), 16.
- ²⁰ Tapestry Networks, *Shaping bank governance in a new era: Enhanced oversight versus radical reform*, 13–14.
- ²¹ David Walker, *A review of corporate governance in UK banks and other financial industry entities*, 10.
- ²² Advisory Committee on the Future of Banks in the Netherlands, *Restoring trust*, 13.
- ²³ 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