

US Bank Leadership Forum

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VIEWPOINTS

Evolving expectations for bank directors

After the crisis, it was clear we needed boards of directors for large banks to step up. Now, there is an opportunity to emphasize the more important things ... to allow boards to focus.

—Participant

The role of a non-executive director at a large bank has become increasingly demanding in recent years. After the financial crisis, boards faced pressure from regulators and shareholders to shore up risk management and oversight. The risks requiring oversight were many—capital and liquidity risks, cybersecurity risks, and conduct risks—and they have only grown in the intervening decade. Boards also oversaw the implementation of a massive regulatory reform agenda. Complicating matters, banks face a competitive landscape that is being transformed by technology, and directors must devote increased attention to these changes and new strategic and operational risks.

Now, however, some of those pressures may be easing as part of a broader shift in tone regarding regulation in the United States. While still maintaining stringent standards for risk governance, supervisors are beginning to encourage directors to focus on the issues that matter most.

At the invitation of Tapestry Networks and EY, non-executive directors, supervisors, and banking professionals have met over the course of several months to share perspectives on the evolving expectations for bank directors and the risks the sector faces. These meetings culminated in a forum on December 4, 2017, in Washington, DC. Directors from the largest US-based regional banks as well as directors from major US subsidiaries of foreign banks were joined by Michael Gibson, director of the Division of Supervision and Regulation at the Federal Reserve Board of Governors, and Morris Morgan, senior deputy comptroller for large bank supervision in the Office of the Comptroller of the Currency (OCC). Over dinner, Richard Davis, chair and recently retired CEO of US Bancorp, shared his perspectives on the challenges and opportunities ahead for bank boards.

This *ViewPoints* synthesizes the perspectives and ideas raised in the meeting and in pre-meeting conversations. *A list of individuals who participated can be found in the Appendix.* The discussions yielded themes and insights of note, summarized in the following sections:

- **The regulatory environment is at an inflection point**
- **Risk governance is adapting to a changing landscape**
- **Discussion with Richard Davis, US Bancorp**

The regulatory environment is at an inflection point

Boards have been focused on implementation of regulatory reforms, ensuring compliance with new and existing rules, and meeting heightened supervisory expectations. With the change in administration, supervisors are focusing on providing relief while retaining the perceived benefits of safety and soundness. Much of the relief is likely to come through changes in supervisory interpretation of Dodd-Frank and other reforms, rather than through major rule changes. That shift includes an explicit revision to the expectations for boards and how supervisors assess governance effectiveness.

Supervisors are recalibrating expectations for directors

In 2011, the Financial Crisis Inquiry Commission highlighted breakdowns in corporate governance as one of the key contributors to the crisis.¹ Though boards certainly do not bear primary responsibility for the failures that led to the crisis, lax governance was perceived to have permitted some firms to act recklessly and take on too much risk. Regulators and boards had to respond. *“After the crisis, it was clear we needed boards of directors for large banks to step up,”* said Mr. Gibson. Boards faced additional scrutiny and expanding responsibilities. The regulatory focus on board accountability persisted, and many directors and executives complained that the demands were forcing them to focus on issues where they could provide only limited value and diverting their attention from their core responsibilities. One director said, *“I think a lot of the regular stuff got pushed off agendas, like strategy, having adequate succession planning for the C-suite, etc., in favor of doing the regulatory stuff.”*

Despite these concerns, boards and management acknowledge that supervisory pressures also had a positive overall impact on governance. Before the meeting, one chair said, *“We realize, to an extent, that the regulations have definitely helped. It has changed the way we view risk, our*

risk tolerance, governance, and the way we view our strategic approach.”

Another director agreed, but stressed that there is still room for improvement: *“Many of the core reforms put in place since the crisis were done for the right reasons and should be maintained. At the same time, the more efficient use of time and resources is something we should be looking at.”*

Regulators agree that it may be time for a readjustment. Mr. Gibson said, *“I think we’re at a point in the cycle where we’re trying to find what needs to be recalibrated in terms of regulations.”*

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– Mike Gibson,
Federal Reserve

The Federal Reserve’s new proposed guidance on board effectiveness

In August of 2017, the Federal Reserve released proposed guidance aimed at clarifying and revising expectations for boards at Fed-supervised institutions.² The proposal is the result of a multiyear review of board director practices at the largest banking organizations. This review assessed “the factors that make boards effective, the challenges boards face, and how boards influence the safety and soundness of their firms and promote compliance with laws and regulations.”³ The comment period on the proposed guidance closes on February 15, 2018.

According to Jerome Powell, the new chair of the Federal Reserve Bank Board of Governors, the intent of the proposed guidance “is to enable directors to spend less board time on routine matters and more on core board responsibilities: overseeing management as they devise a clear and coherent direction for the firm, holding management accountable for the execution of that strategy, and ensuring the independence and stature of the risk management and internal audit functions.”⁴ While sharing insight into the guidance, Mr. Gibson said, *“The long checklists, wasted hours, and overlapping requirements kept coming back as concerns from directors, and we wanted to help improve that.”* While the changes are intended to streamline the supervisory approach, Governor Powell has been clear that bank directors should not expect life to get much easier: “Across a range of responsibilities, we simply expect much more of boards of directors than ever before. There is no reason to expect that to change.”⁵

The proposed guidance would clarify “supervisory expectations for boards as distinct from expectations for senior management and identifies five key attributes of effective boards of directors.”⁶ It also would permit institutions to provide self-assessments of the effectiveness of its board of directors relative to those five attributes. Although there was some confusion among participants regarding the Fed’s expectations for the self-assessments, Mr. Gibson assured them that the self-assessments are optional and intended as

a tool to assist in discussions with supervisors, not as a replacement of boards' normal assessment processes: *"We can address this confusion through the public comment process. We are looking for boards to govern themselves effectively, and we are also open to boards providing input to us on the areas where they think they are doing well and the areas they do not think they are doing well in light of this guidance."*

The proposal is broadly consistent with both the heightened standards for large banks issued in 2014 by the OCC and the corporate governance principles for banks published by the Basel Committee for Bank Supervision in 2015.⁷

Proposed guidance on board effectiveness

The Fed's proposal identifies five key attributes of effective boards:⁸

1. **Set clear, aligned, and consistent direction.** "An effective board ... guides the development of and approves the firm's strategy and sets the types of levels of risk it is willing to take."
2. **Actively manage information flow and board discussions.** "An effective board ... actively manages its information flow and deliberations so that it can make sound, well-informed decisions in a manner that meaningfully takes into account risks and opportunities."
3. **Hold senior management accountable.** "An effective board ... holds senior management accountable for implementing the firm's strategy and risk tolerance and maintaining the firm's risk management and control framework. An effective board of directors also evaluates the performance and compensation of senior management."
4. **Support the independence and stature of independent risk management and internal audit.** "An effective board ... through its risk and audit committees, supports the stature and independence of the firm's independent risk management and internal audit functions."
5. **Maintain a capable board composition and governance structure.** "An effective board has a composition, governance structure, and established practices that support governing the firm in light of its asset size, complexity, scope of operations, risk profile, and other changes that occur over time."

Reestablishing the board's role as one of oversight

Critics of bank supervision in the wake of the financial crisis complained of a conflation of the roles of the board and management, with boards being pushed into reviewing, approving, and ensuring at a level of detail that many suggested went beyond oversight. Regulatory guidance and letters from this period often referred to “management and the board” without clarifying what was expected of each. Mr. Gibson noted that one of the Fed’s intentions with the current proposal is to clarify that the board’s role is one of strategic oversight: *“That’s why part of the package was to rescind things that maybe blur the line between boards and management. We are working on clarifying that language.”* Mr. Morgan noted that even when the OCC takes care to avoid conflating the board and management in their guidance, *“the outcome can be the same.”* He acknowledged the need to work with examiners to ensure that roles and expectations are differentiated in practice.

“Hopefully, once the proposal is finalized, directors will feel they are spending less time on regulatory box checking and more on strategic approach,” Mr. Gibson said. To further that aim, the proposal would end the requirement that Fed examiners direct all matters requiring attention (MRAs) and matters requiring immediate attention (MRIAs) to boards of directors or executive board-level committees.⁹ Instead, Fed examiners would direct senior management, not the board, to take corrective action relating to MRAs and MRIAs in all but two circumstances: (1) where significant weaknesses in the institution’s board governance structure and practice are identified, or (2) when senior management fails to take proper action to correct material deficiencies or weaknesses.¹⁰

Similarly, the OCC’s Mr. Morgan described MRAs as deficiencies that need to be corrected. As such, when discussing potential MRAs he said, *“I ask examiners, What do you expect me to do about it? If we would not consider some kind of enforcement action if the bank fails to address the deficiency, then it probably shouldn’t be an MRA.”*

Managing information flows to the board

The second key attribute of effective boards outlined in the Fed’s proposed guidance places responsibility for managing information flow from management squarely on the board. The board must work with management to ensure the board is focusing on the right things, getting the right information at the right level of detail, and efficiently managing its agendas. One participant complained that management does not make this easy: *“Management is part of the reason we’ve ended up here. We’ll often find*

situations where management is just dumping information on the board with very little quality analysis. I call it board burden, and management certainly contributes.”

Directors understand that their jobs include complex analysis and that information flow is a board and management responsibility, not a regulatory one. One said, *“We don’t think of it as a regulatory issue but rather our issue to manage. At the end of the day, that’s our problem, as we made the choice to join complex financial institutions.”*

This supervisory recalibration is intended to allow directors to dedicate their time and energy to strategic issues, not to ease the overall burden of board service. For example, the Fed’s Comprehensive Capital Analysis and Review as an example of a regulatory requirement demanding perhaps an undue amount of board attention, but Mr. Gibson responded, *“Capital planning is a really important thing for banks ... We want boards worried about capital.”*

Reacting to evolving expectations and revised guidance

Directors welcomed the tone and spirit of the Fed’s proposal and other supervisory efforts to adjust their approaches to boards. A participant said, *“The spirit of what you’re doing, the willingness to rethink and innovate, we really appreciate that.”* A director expressed the same sentiment in a pre-meeting conversation: *“I think it’s fair to say that everyone likes the direction [supervision] appears to be heading. It will get boards out of the weeds and able to stop focusing on so much unnecessary detail.”*

While participants appreciate the efforts of the Fed and other regulators, questions remain about how new expectations will be translated into practice. One participant said, *“My concern is about a potential gap between what the proposal says and what the actual supervisors think their role is. How supervisors carry it out will be huge.”* Participants highlighted two challenges to meaningful implementation:

- **Driving new expectations down through supervisory organizations.** Participants are curious to see how the new supervisory expectations will travel down to the lead supervisors and examiners working directly with banks. A participant said, *“Tone at the top may not carry down for a variety of reasons. We’ll have to see how that plays out.”* Regulators acknowledged that training their field examiners is a work in progress. *“There will certainly be a lot of internal conversations with our supervisors. It will go into our training practices, which are updated regularly. We want things to be consistent, so the implementation stage*

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– Mike Gibson,
Federal Reserve

“The supervisors aren’t the only ones that will have to go through a cultural change ... we’ll also need to change.”

– Director

will come later, once we’re past the comment stage,” Mr. Gibson said. This presents a window in which boards and management teams can work with supervisors to ensure clear communication about the new expectations.

- **Reworking board focus to reflect supervisory changes.** For supervisory changes to be effective, boards must continue to update practices and find ways to be more efficient. One director opined, *“The supervisors aren’t the only ones that will have to go through a cultural change. As directors, we behave as we do for a reason, so we’ll also need to change.”* For their part, regulators noted that they expect to engage with both management and directors to continue to refine approaches and ensure expectations are clear. Boards will need to work with management to ensure they can effectively manage and focus their agendas, while also getting the right level of information to satisfy supervisors. In a pre-meeting conversation, a director said, *“It’s going to take time for all three—the company, board, and regulators—to get to the right level and balance.”*

The challenge for supervisors will be balancing the desire for greater flexibility in how boards spend their time with the need for clarity and precision of language. Mr. Morgan observed, *“We don’t want overly prescriptive guidance, but we then worry about the industry not understanding expectations. There is no one-size-fits-all. Effective guidance requires balancing general expectations with application, given the facts and circumstances in each situation.”*

Evolving expectations are part of a broader shift in supervision

The evolution in supervisory expectations of boards is part of a broader shift in the approach to financial regulation in the United States. While most observers see major legislative changes as increasingly unlikely, administration leaders have made clear their intent to simplify and streamline regulation through other mechanisms, particularly regulatory authorities’ interpretations of rules and supervisory standards, a point underscored by President Trump’s senior economic adviser Gary Cohn in October.¹¹ Treasury Secretary Steven Mnuchin similarly pointed out that only a small portion of the Treasury’s recommendations concerning regulatory reforms would require changes of law: “We were very focused on what we can do by executive order and through regulators. We think about 80% of the substance in the [Treasury] report can be accomplished by regulatory changes, and about 20% by legislation.”¹²

“There is no one-size-fits-all. Effective guidance requires balancing general expectations with application.”

– Morris Morgan,
OCC

Mr. Morgan stated, *“There are some things that may need to be addressed legislatively. But as supervisors, we’re looking at a number of things where it may just be a matter of interpretation. In those instances, maybe there is no regulation or legislative change needed, but rather deciding what should be done to provide the necessary level of relief without compromising safety and soundness.”*

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– Morris Morgan,
OCC

The changes in regulatory interpretation and implementation are likely to be driven by new leadership at the major regulatory authorities. *“I think there’s a general consensus of needing to find balance. Part of the balance starts with tone at the top,”* Mr. Morgan said. Joseph Otting, the new comptroller of the currency, said in a statement upon taking up the post, *“In my experience, bankers support regulation, but effective regulation evolves with the changing needs of the nation and should be reviewed and modified as those needs change.”*¹³

Randal Quarles was confirmed in October 2017 as the Fed’s vice chair for supervision, the first person to hold the position, which was created in an effort to enhance the Fed’s emphasis on financial stability and regulation. Quarles suggested in his confirmation hearing that adjustments to regulatory policy were on the horizon: *“As with any complex undertaking, after the first wave of reform, and with the benefit of experience and reflection, some refinements will undoubtedly be in order.”*¹⁴

Generally, the move will be toward more tailored, risk-based approaches. Those could include an increase in the threshold for being classed as a domestic systemically important bank. Under Dodd-Frank, that threshold is currently \$50 billion in assets. Many regional banks that meet that threshold have argued that their businesses do not present a systemic threat and that the regulatory burden on them should be reduced. One participant cautioned, however, *“We can raise the quantitative threshold, but there is very little in the OCC [or] Fed responses to Dodd-Frank that was tied to it ... Expectations for relief may be too high.”*

Risk governance is adapting to a changing landscape

“We’re really having a hard time fitting these newer issues into the risk appetite framework.”

– Participant

A major focus of supervisors and banks has been improving risk management and oversight. Banks have made major strides in developing risk appetite frameworks, revising risk metrics and reporting to the board, empowering the risk function, and changing reporting and governance structures. A chair stated, *“The essence of bank governance is understanding risk.”* With the banking industry in the midst of a digital transformation and the competitive landscape undergoing unprecedented change, the risks of greatest concern to directors are changing.

Ultimately, as one commentator asserted, “the most important challenge that directors face [is] determining how to balance the need to make an objectively measurable profit against more subjective judgments about how much risk a bank can safely assume. If directors mess up that job, not much else matters.”¹⁵

Technological transformation is increasing strategic risk

As technology transforms the competitive landscape and bank operations, strategic risk and operational risks have moved to the fore for boards and their risk committees. These risks are hard to quantify, are rapidly changing, and the metrics and reporting around them is less mature. Several participants noted the difficulties in assessing these non-financial risks, with one saying, *“We’re really having a hard time fitting these newer issues into the risk appetite framework.”* It can be hard to agree on a suitable appetite for operational risks such as cyber, conduct, or compliance risks, which makes it difficult to set tolerances and to know whether the bank is staying within its aggregate risk appetite. These risks are also often outside the core areas of experience and expertise for many directors.

Business model and strategic risk

“Business risk in banking is at an all-time high.”

– Director

Large regional banks are being squeezed competitively from all sides: by fintech start-ups and technology giants currently unencumbered by high levels of regulation, by community banks that can offer a superior level of customer intimacy, and by global banks with the scale and capital to invest in technology and acquisitions. Technology is upending the risk landscape for large regional institutions, and there are additional factors at play that are likely to enable new business models or disrupt existing ones. A director stated, *“Business risk in banking is at an all-time high.”*

Non-executive directors are working to keep up with the pace of technological advancements and new applications in banking, to separate the

hype from the reality of emerging competitive threats, and to understand where and how a bank should invest in innovation and new opportunities. A director said, *“Part of the issue is, we don’t know which of these opportunities is going to be the big thing. Which is going to replace us and which is just a fad? It makes strategy difficult.”* And banks are investing in an environment where interest rates are low and likely to increase very slowly, putting pressure on net interest margins.

Many leaders are also concerned about the technology giants entering the banking fold. A recent survey found that 31% of banking and insurance customers globally would consider switching their accounts to Google, Amazon, or Facebook if the tech giants offered financial services.¹⁶

Directors identified this as a very real concern that should be figured into long-term strategic approaches. *“It’s a battle out there, and who’s winning the battle right now? It’s the technology giants. They’re the possible future competitors ... Banks need to admit that is the future and the truth of the competition we’re facing,”* one director asserted.

Although the financial services sector has watched the rise of fintech firms warily, the newcomers are also potential partners. More and more, regulated financial institutions are outsourcing operations to third-party providers and partnering directly with fintech firms. These developments are allowing financial institutions to provide new offerings to customers, but are also making financial institutions vulnerable in new ways: when third parties have access to bank systems and customer accounts, a systems glitch from a third-party provider can bring a large bank’s business to a halt. In addition, outsourcing distances banks from their customers, which can be bad for the customer-bank relationship.

Participants identified additional obstacles that banks face when developing strategy and assessing risk in the current environment:

- **Being too cautious can be a risk itself.** Speaking in a pre-meeting conversation, one participant said, *“Choices made today will determine if banks are viable competitors five or 10 years from now.”* With the fate of the institution potentially at stake, it is natural for the board to be cautious, but one director asserted, *“Figuring out how to be prudent is important, but there’s great risk to moving too slowly as well. You can look up one day and the business is gone.”*

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– Director

- **Reputational risk sets banks apart.** In many cases, banks have built up trust with their customers over decades. *“I think that’s the biggest difference, the reputational risk,”* said one director, *“We can’t afford to go fast and break things.”* Non-bank competitors have more freedom than banks when it comes to trying new products and approaches with customers. Boards understand that they must find a way to compete with these new entrants: *“Simply put, you have to do it. Disruption is coming, so you don’t have the choice to be complacent.”*

One director said, *“There will have to be a focus on innovation and trying to understand customers. Just like in the retail world, where people aren’t going to stores anymore, the model can still work when it’s rearranged. Banks need to strike some of that balance as well.”*

Information security and cyber risk

In many ways, data stewardship represents the very core of what banking institutions have built their businesses and brands upon: protecting and managing client information and money. Because they do handle money and valuable financial data, banks are among the most targeted institutions for cyberattacks.¹⁷ And digitalization of banking has increased banks’ vulnerability to attack. Taken together, these facts make information security a top priority for bank boards. In a recent survey of risk professionals, “cyber risk and data security” was the number one operational risk concern for 2017, and participants broadly agreed that it easily falls within the top three risks that their boards currently face.¹⁸

The gravity of the risk has prompted regulators and other stakeholders to put additional pressure on boards. In the United States, the Federal Deposit Insurance Corporation, the OCC, and the Federal Reserve have jointly proposed enhanced cyber risk management standards for financial institutions in the form of an advance notice of proposed rulemaking. According to an EY briefing report, the proposed rules require the development of a board-approved cyber risk management strategy, as well as a board-approved cyber risk appetite statement. In addition, firms will be obliged to take an inventory of all business assets and their criticality and to monitor in real time all external dependencies.¹⁹

Cybersecurity is a topic that tests board oversight because cyber risk is constantly changing, and boards often feel limited in their ability to have a meaningful impact on firm efforts. As oversight of cyber risk continues to mature, there are indications that boards are refocusing their approach in key areas:

“Disruption is coming, so you don’t have the choice to be complacent.”

– Director

“It’s gotten to the point where we accept that a breach is going to happen. It’s just a question of when.”

– Participant

- **Shifting the focus to response.** A participant said, *“It’s gotten to the point where we accept that a breach is going to happen. It’s just a question of when.”* Other participants agreed. The Equifax hack, which resulted in 145.5 million Americans having their Social Security numbers compromised, is a sobering object lesson not only in terms of the magnitude of the damage but also the criticism the company received regarding its response.²⁰ Responding effectively to a breach requires management and the board to be notified as early as possible, something that concerns participants. *“It’s not just how you know you’ve been hacked, it’s how quickly you know. Sometimes it takes several months,”* said one participant.

- **Working to better assess information related to this risk.** Directors are looking for better information from management to help them size the risk, understand what is being done to mitigate it, and benchmark against good practices. *“The difficult part is the qualitative part: what does all the information mean? I get a fair amount of data, but knowing what to do with it is the challenge now,”* said a participant. Banks are refining risk metrics and, where measurement is particularly challenging, choosing indicators that track the effectiveness of mitigation and management efforts and how risks are trending over time.

“A lot of risk here comes down to the behavior of people. How are you training people and holding them accountable?”

– Participant

- **Addressing the inside threat.** A director said, *“Cyber makes people think too much about penetration, but the issue is usually we ourselves are the weak link. We need to be asking how effective our employees are at not having bad habits.”* Indeed, although headline-making security breaches tend to feature nefarious foreign actors who overwhelm a firm’s security, a 2016 study found that 60% of all attacks were caused by insiders.²¹ When it comes to prevention, participants noted that they are increasingly looking at practices among employees within their own institutions. Insider cyber threats and related risks are prompting banks to identify new ways to monitor employees and systems. One participant noted the importance of training: *“A lot of risk here comes down to the behavior of people. How are you training people and holding them accountable?”*

Board composition is gradually adapting

In the years after the crisis, banks were pressed to make sure they had sufficient financial and risk expertise on their boards. As the nature of the risks banks face evolves, the composition of boards may need to evolve along with it. Because technological advances are both sources of risk and a potential means of addressing those risks, there is an ongoing debate about

whether and to what extent boards need directors with greater technological expertise, with many directors cautioning against specialization or chasing the latest trends. One approach, adopted by a number of banks, has been to add a separate technology committee to their boards. One participant emphasized the value of a specialized committee, saying, *“From a board knowledge standpoint, having those skill sets has been remarkable. Having the tech committee as a stand-alone committee is very helpful.”*

“I think it’s incredibly helpful to have non-bankers on the board, particularly those with tech backgrounds.”

– Director

Several directors were supportive of adding technical experts to the board. One stated, *“I think it’s incredibly helpful to have non-bankers on the board, particularly those with tech backgrounds. They have a different way of thinking, and it’s good to have a blend of skill sets and thought provokers.”* Despite the benefits, many boards have been slow to bring on technological expertise. In 2016, only 57% of the world’s 109 largest banks had at least one board member with professional technology experience.²² It is also possible to access technological expertise without bringing an expert onto the board. Participants mentioned incorporating tech-focused educational sessions into their meetings, contracting with technology firms for regular updates and insight, and having select board members work with management to learn a specific topic which the member then explains to the rest of the board.

Discussion with Richard Davis, US Bancorp

Participants were joined by Richard Davis, chair and recently retired CEO of US Bancorp, for a discussion over dinner. Mr. Davis shared his perspectives on the challenges and opportunities ahead for bank boards. His comments are summarized below.

- **Boards should focus on the basics.** Mr. Davis reminded participants that despite expanding expectations for directors, the core of the board’s responsibility has not changed: *“As board members, your fiduciary responsibility is for the financial success of the company.”* Specifically, he said boards should pay close attention to two areas: the yield curve and interest rates. Both impact net interest margins for banks. Mr. Davis stated, *“Yield curve itself is the biggest lever, but rate increases have almost as much impact on the financial income of your company.”* Regarding tech transformation and the potential competitive threat from fintech, Mr. Davis emphasized the need to remain focused on traditional banking risks: credit risk, compliance risk, and balance sheet risk.

“Your decisions as a board member often do not truly start to reflect themselves for five to 10 years after they are made ... You need to be asking how sustainable current performance is.”

– Richard Davis,
US Bancorp

- **Fintech’s threat is greatest for payments.** When asked about the competitive threat from tech companies and fintech, Mr. Davis said, *“Fintechs are much more interesting [than tech giants]. Their front end runs circles around us, but after that we say we’ll take it from here, because their back end doesn’t hold a candle to ours. The payment space is a bigger concern to me.”*
- **Boards have a unique ability to focus on the long term.** The need to meet quarterly earnings expectations can make it difficult for management to focus on long-term investment. Mr. Davis emphasized that boards must be patient in taking a long-term view: *“Your decisions as a board member often do not truly start to reflect themselves for five to 10 years after they are made ... You should ask management, What is your sustainability quotient? You need to be asking how sustainable current performance is.”*
- **Management selection and succession planning is essential.** *“Selection, activism, and succession; these should be priorities going forward,”* said Mr. Davis. Highlighting the importance of having a well-developed succession plan in place, Mr. Davis shared, *“I announced three years ahead of when I would leave, and it worked well. You need to have three names from outside the company for CEO succession, where if the CEO got hit by a bus tomorrow, here’s who the board would want to talk to.”*
- **Culture should be a board priority.** Culture in banking has garnered a lot of attention from the public and from supervisors, both in wholesale banking regarding risk culture and in retail banking where sales practices have come under scrutiny. Boards should understand the current culture and define the desired culture; they need ways to assess culture in their banks. Mr. Davis said, *“Culture and brand are not the same. Brand is how the company is perceived from the outside; culture is what it’s like from the inside. Ask yourself if you know what it means to be within the company. What is it like to work there?”* He went on to highlight employee engagement as a vital aspect of evaluating culture. A key question to ask employees, he said, is, *“Do you believe in the vision of the company, and do you see yourself here in five years? That gets to culture.”* New board members or directors taking on new responsibilities need to be aware not only of current culture practices, but also the legacy for which they are now taking responsibility. *“What matters is that when you inherit something, you need to own it, to audit it,”* and that includes culture, he said.

“Culture and brand are not the same ... Ask yourself if you know what it means to be within the company. What is it like to work there?”

– Richard Davis,
US Bancorp

- **Investor activism and engagement is increasing.** Banks have largely been insulated from investor activism, but as activists partner with institutional investors, and institutional investors put additional pressure on investee companies, that is changing. *“The CEO really wants to be involved with institutional investor engagement. Institutional investors really want to know what boards are doing, and the CEO can help with that conversation. But, I would encourage you to think: What kind of activist will come into this industry?”* said Mr. Davis. A 2016 report noted that in 2017, Institutional Shareholder Services planned to spend more time focusing on director compensation and performance.²³ Additionally, in 2018 the SEC’s pay ratio disclosure rule will be implemented, requiring public companies to share the pay ratio between the company’s median employee and the company’s CEO. Mr. Davis addressed these coming changes and noted that they should represent a significant concern for bank boards, because banks have highly paid executives, but also tellers and other employees that could make the pay ratio look particularly lopsided.
- **Social issues are increasingly important.** Managing public perception, reputation, and brand is important in the world of political volatility, increasing extremism, and social media. Historically, it has been safer for senior management to stay silent on social issues to avoid alienating or offending customers. That is changing. Corporate leaders are increasingly being asked to voice their stance on wide-ranging and complicated public matters.²⁴ In some cases, it may now actually be riskier for company leadership to stay silent than to speak out. Mr. Davis noted this changing dynamic within the banking industry: *“Boards need to be asking if they trust their CEO to speak on social issues, because that is becoming an important part of the role ... When you speak on social issues, you are doing it for your company and your community, and you better get it right. Employees will care.”*

“In a data-driven industry, the institutions that sit on that data have a significant advantage over start-ups.”

– Director

While the job of being a bank director is not getting any easier, directors are optimistic that the recent changes will lead to a more strategic focus for boards, reduce misspent time and energy, and clarify what is expected of boards. Still, a participant reminded the group, *“The core regulatory reforms were done for good reason,”* and another noted, *“There have been cases where governance effectiveness was absent, below adequate.”* Banks and their boards will continue to be held accountable for how they manage and oversee risk.

While large banks face clear challenges, there are also opportunities on the horizon in the coming years. *“It’s a real chance for banks to serve their clients differently,”* a director said. *“My view is that in a data-driven industry, the institutions that sit on that data have a significant advantage over start-ups.”* Determining how to take advantage of these opportunities, while balancing the ever-growing list of risks, is a crucial challenge for bank boards.

Appendix: discussion participants

On December 4, 2017 in Washington, DC, Tapestry and EY hosted the US Bank Leadership Forum, which brought together directors of large regional banks in the US with senior supervisors from the Federal Reserve and the OCC. The discussion focused on supervisory expectations for bank directors and the changing risks facing the sector, as well the shifting US regulatory landscape and its implications for large banks. Insights from these discussions and numerous additional conversations with directors, regulators, supervisors, and other thought leaders informed this *ViewPoints* and quotes from these discussions appear throughout.

The following individuals participated in these discussions:

Participants

- Shelaghmichael Brown, Non-Executive Director, BBVA Compass
- Mike Collins, Non-Executive Director, Comerica
- Gary Crittenden, Non-Executive Director, Zions Bancorp
- Richard Davis, Executive Chairman, US Bancorp
- Mike Gibson, Director, Division of Supervision and Regulation, Board of Governors of the Federal Reserve System
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- Barry Kroeger, Non-Executive Director, HSBC North America Holdings
- Alan MacGibbon, Audit Committee Chair, TD Bank; Audit Committee Chair, TD Bank N.A.
- Morris Morgan, Senior Deputy Comptroller, Large Bank Supervision, Office of the Comptroller of the Currency
- Ed Murphy, Audit Committee Chair, Zions Bancorp
- Rick Neu, Audit Committee Chair, Huntington Bancshares
- Pat Phillips, Finance and Audit Committee Chair, USAA Federal Savings Bank
- Peter Raskind, Risk Committee Chair, Capital One Financial Corporation
- Nancy Shanik, Non-Executive Director, RBC US
- Don Shepard, Presiding Director, Nominating and Governance Committee Chair, and Executive Committee Chair, PNC
- Mike Van Handel, Audit Committee Chair and Nominating & Governance Committee Chair, BMO Harris
- Lee Vardaman, Non-Executive Director, BBVA Compass
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