February 9, 2024

James P. Sheesley
Assistant Executive Secretary
Attention: Comments/Legal OES (RIN 3064–AF94)
Federal Deposit Insurance Corporation
550 17th Street NW
Washington, DC 20429

Re: Guidelines Establishing Standards for Corporate Governance and Risk Management for Covered Institutions with Total Consolidated Assets of $10 Billion or More [RIN 3064–AF94]

Via: comments@FDIC.gov

Dear Mr. Sheesley:

I am pleased to submit these comments regarding the "Guidelines Establishing Standards for Corporate Governance and Risk Management for Covered Institutions with Total Consolidated Assets of $10 Billion or More."[1]

Introduction

This proposed rule would add a new Appendix C to the safety and soundness regulations found at 12 CFR §364.101. The proposed Appendix and the associated proposing release are impressive in one respect. They contain literally no analytical, economic or empirical basis whatsoever for the detailed, prescriptive requirements imposed by the Appendix and do not really even pretend to. The proposing release utterly ignores the voluminous finance, economics, accounting and legal literature on the impact of corporate governance on financial risks and financial returns. It is a quintessential exercise in arbitrariness. The proposed Appendix is a notable intrusion into both state corporate governance laws and both board authority and accountability Its authors are seemingly oblivious to possible adverse consequences. Most notably, the proposed Appendix seeks to mandate a "stakeholder' conception of board duties in contravention to most state laws. Thus, rather than promoting the safety and soundness of banks subject to the proposed requirements, the proposed Appendix C will actually endanger the safety and soundness of banks. The proposed Appendix makes no effort to consider how it interacts, conflicts or coordinates with related requirements imposed by other bodies, most notably the Securities and Exchange Commission and self-regulatory organizations (SROs).[2] Lastly, key aspects of the proposed Appendix are beyond the scope of the FDIC's statutory authority.

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[1] "Guidelines Establishing Standards for Corporate Governance and Risk Management for Covered Institutions with Total Consolidated Assets of $10 Billion or More," Federal Deposit Insurance Corporation, Notice of Proposed Rulemaking and Issuance of Guidelines, *Federal Register*, Vol. 88, No. 195, October 11, 2023, pp. 70391-70409 https://www.govinfo.gov/content/pkg/FR-2023-10-11/pdf/2023-22421.pdf. See also "Guidelines Establishing Standards for Corporate Governance and Risk Management for Covered Institutions with Total Consolidated Assets of $10 Billion or More, Federal Deposit Insurance Corporation, Notice of Proposed Rulemaking and Issuance of Guidelines, *Federal Register*, Vol. 88, No. 231, December 4, 2023, p. 84089 (extending the comment period).

[2] Including FINRA, the NYSE and Nasdaq.

The Proposed Appendix Lacks Analytical, Economic or Empirical Foundation

There are recitations throughout the proposing release that good corporate governance and risk management will make banks more safe and more sound. Who can argue with that?

What does *not* exist anywhere in the proposing release is any analytical, economic or empirical predicate for the proposition that the manifold requirements in proposed Appendix C itself will further the safety and soundness of the banks that must comply with it.

Let us examine, for example, the diversity requirements imposed by Appendix C. Part II.B. of the proposed Appendix C reads, in relevant part, as follows:

> *Board Composition*. The covered institution's organizational documents or state chartering authority may have requirements for board members, including the appropriate number of members on its board of directors. However, in determining the appropriate number of directors and the board's composition, the board should consider how the selection of and diversity among board members collectively and individually may best promote effective, independent oversight of covered institution management and satisfy all legal requirements for outside and independent directors. Important aspects of diversity may include: social, racial, ethnic, gender, and age differences; skills, differences in experience, perspective, and opinion (including professional, educational, and community or charitable service experience); ...

This is the entirety of the justification for this requirement in the proposing release:

> *Diversity of demographic representation, opinion, experience, and ownership level is key to a board composition that can oversee management, address a variety of risks, and challenge others when necessary. A board that includes multiple members with similar experiences, opinions, or interests in the covered institution may result in a lack of creativity or individual responsibility for decisions, or gaps in knowledge, experience, or oversight, increasing risk to the institution.* (emphasis added)
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> The covered institution's organizational documents or state chartering authority may have requirements for board members, including a requirement for a certain number of directors. The proposed Guidelines expand upon, but do not replace, these requirements by providing covered institutions various considerations for ensuring an effective board composition. In determining the appropriate number of directors and the board's composition in accordance with state law, the board should consider how the selection of, and diversity among board members collectively and individually, may best promote effective, independent oversight of the covered institution's management and satisfy all legal requirements for outside and independent directors. (p. 70395)

The italicized two sentences above are the *only* part of the entire proposing release that can be characterized as making an argument for the provision in section II.B. The problem is that there is a substantial and complex literature of the subject of board diversity and the FDIC utterly, entirely ignores that literature.[3] Not all kinds of diversity are created equal. Some types of diversity arguably affect returns and therefore safety and soundness. For others, there is literally no evidence that returns or safety and soundness are affected or there is evidence that the effects are empirically negative. Yet the proposing release does not engage with this literature at all. It marshals neither facts, nor arguments, nor evidence. It is simply imposing a requirement without so much as a mention of the evidence, facts or data. That is the very definition of arbitrary and capricious.

There is a genuinely voluminous literature, going back decades, relating to the impact of corporate governance on financial returns and financial risk and regarding what constitutes *good* corporate governance.[4] Some of this literature is general and some addresses banks in particular.[5] The proposing release shows utterly no familiarity with this literature, its findings and its complexity. In other words, the proposing release is uninformed by facts, data, evidence and analysis developed over a long period of time by the finance, economics, accounting and legal professions. The FDIC can and must do better. It should not engage in arbitrary regulation. U.S. banking regulation should be based on facts, evidence and sound analysis. The proposed Appendix C is not.

What is really going on here is an effort by the FDIC to comply with the White House's various DEI Executive Orders[6] and to promote progressive political objectives unrelated to the FDIC's mission (both DEI requirements and, as discussed below, the implementation of 'stakeholder capitalism'). The Appendix is not really an effort to improve the safety and soundness of banking institutions and the proposing release does

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[3] For a very brief introduction to the literature, see Comments of Brian Knight (Director and Senior Research Fellow, Program on Innovation and Governance, Mercatus Center at George Mason University) to the FDIC regarding Proposed Rule on Guidelines Establishing Standards for Corporate Governance and Risk Management for Covered Institutions with Total Consolidated Assets of 10 Billion Dollars or More, November 17, 2023 https://www.fdic.gov/resources/regulations/federal-register-publications/2023/2023-guidelines-establishing-standards-for-corporate-governance-3064-af94-c-003.pdf and David R. Burton, Nasdaq's Proposed Board-Diversity Rule Is Immoral and Has No Basis in Economics, Heritage Foundation Backgrounder No. 3591, March 9, 2021 https://www.heritage.org/sites/default/files/2021-03/BG3591_0.pdf.

[4] See, for example, Diane K. Denis, "Twenty-Five Years of Corporate Governance Research … and Counting," *Review of Financial Economics*, Vol. 10, No. 3, 2001, pp. 191-212; Inessa Love, "Corporate Governance and Performance around the World: What We Know and What We Don't," *The World Bank Research Observer*, Vol. 26, No. 1 (February 2011), pp. 42-70.

[5] See, for example, Catarina Fernandes, Jorge Farinha, Francisco Martins, and Cesario Mateus, "Bank Governance and Performance: A Survey of the Literature," *Journal of Banking Regulation*, Vol. 19 (July 2018).

[6] See Executive Orders 13985 ("Advancing Racial Equity and Support for Underserved Communities Through the Federal Government," dated January 20, 2021), 13988 ("Preventing and Combating Discrimination on the Basis of Gender Identity or Sexual Orientation," dated January 20, 2021), 14020 ("Establishment of the White House Gender Policy Council," dated March 8, 2021), 14031 (Executive Order on Advancing Equity, Justice, and Opportunity for Asian Americans, Native Hawaiians, and Pacific Islanders," dated May 28, 2021), 14035 ("Diversity, Equity, Inclusion, and Accessibility in the Federal Workforce," dated June 25, 2021), and 14091 ("Further Advancing Racial Equity and Support for Underserved Communities Through The Federal Government," dated February 16, 2023).

not really make any serious effort to claim that it is (unless you count the two italicized sentences above).

The Proposed Appendix Conflicts with Other Laws and Violates the Major Questions Doctrine

The proposed Appendix C is a breathtaking intrusion into corporate governance.

Probably the most problematic is section II.A. (Board of Directors—General Obligations):

> The board, in supervising the covered institution, should consider the interests of all its stakeholders, including shareholders, depositors, creditors, customers, regulators, and the public.

This is a nearly comprehensive list of potential stakeholders, although the omission of 'employees" is interesting. I suppose, however, that the term 'the public' would capture bank employees.

In any event, such a sweeping 'stakeholder' requirement is inconsistent with most state corporate statutes which require that Boards either act in the interest of shareholders or 'the corporation.' The FDIC most certainly does not address how it expects boards of directors to *actually* comply with this provision. First, it blithely ignores the inconsistency of the proposed rule with most state corporate law. Second, it blithely ignores how boards are supposed to "balance the interests of all its stakeholders," including "the public." The interest of those 'stakeholders' will inevitably conflict.

The reason the FDIC doesn't do this is that the stakeholder conception of corporate governance is inherently amorphous (at best) and, in my judgment, simply intellectually incoherent. It will lead to (1) increasingly unaccountable bank managements since the metrics by which boards will be evaluated become impossibly amorphous and (2) regulation by enforcement that is inherently arbitrary (because which enforcement action is launched will depend on which stakeholder the regulator du jour finds to be most worthy of political attention by the regulator).

Traditionally, the purpose of a business has been to earn a return for its owners by cost-effectively combining the capital and entrepreneurial spirit of its owners with the labor and talent of its employees in a competitive environment to satisfy the wants and needs of its customers. Any well-run business must show due regard for its employees (otherwise their morale and productivity will decline or they will leave to work elsewhere), its customers (otherwise revenues will collapse), its suppliers (otherwise the business will be unable to operate) and its community (otherwise its public reputation and its relationship with local officials will suffer). Nevertheless, the primary reason that companies are formed and that investors put their capital at risk (either to launch the company or by purchasing company securities on secondary markets like a stock exchange) is to earn a return.

The proposed Appendix is an effort to upend virtually every state's corporate law by regulatory fiat. It is the proverbial attempt to hide an elephant in a mousehole, where the mousehole is an Appendix to a safety and soundness regulation and the elephant is reversing the statutory duties of corporate directors under virtually every state's law. This is precisely what the Supreme Court prohibited with its major questions doctrine discussion in *West Virginia v. Environmental Protection Agency*.[7]

Furthermore, the proposed Appendix does not consider the interaction with other federal corporate governance requirements, notably those imposed by the SEC, or those of SROs such as FINRA, the NYSE or Nasdaq (the rules of which must be approved by the SEC). There are existing SEC and SRO rules (approved by the SEC) governing internal controls, audit committees, the independence of directors, shareholder proposals, and so on. Internal controls, audit committees and the independence of directors are issues that the proposed Appendix addresses. The problem of potential conflicts will worsen. Nasdaq has recently imposed a board diversity rule. The SEC is considering a Corporate Board Diversity rule (RIN 3235-AL91) and a Human Capital Management rule (RIN 3235-AM88) that will overlap with the requirement imposed by the proposed Appendix. To the extent that the FDIC requirements and those of the SEC or SROs conflict or use different standards, how are these issues to be resolved? If the FDIC is going to move past traditional safety and soundness regulation and wade into the corporate governance space, it needs to seriously consider these issues. While there is a general statement that other statutes and regulations may apply, there is no evidence that the FDIC seriously considered the interaction of the proposed Appendix with these rules (both existing and forthcoming).

The Proposed Appendix Will Harm rather than Enhance Banks' Safety and Soundness

By mandating that bank boards consider just about everything except return and risk, the proposed Appendix makes it more likely that these banks will fail. The stakeholder and diversity mandates in the proposed Appendix are at particular cross purposes with ensuring the safety and soundness of banks for the protection of depositors and taxpayers. The extreme prescriptiveness of the proposed Appendix also means that bank boards will be unable to adjust or be flexible and that a 'one size fits all' mentality will have adverse consequences as banks try to manage risk in the real world.

The Proposed Appendix Exceeds the FDIC's Statutory Authority

The relevant FDIC statutory authority is found at 12 U.S. Code §1816 (factors to be considered regarding whether to provide deposit insurance), 12 U.S. Code §1819 (relating to corporate powers) and 12 U.S. Code § 1831p–1 (relating to standards for safety and soundness). The most relevant of these provisions is the latter one since the

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[7] *West Virginia v. Environmental Protection Agency*, 597 U.S. ___ (2022) https://www.supremecourt.gov/opinions/21pdf/20-1530_n758.pdf ("Nor may agencies seek to hide "elephants in mouseholes.")

proposed Appendix purports to be a safety and soundness regulation. It provides, in relevant part:

> 12 U.S. Code § 1831p–1 - Standards for safety and soundness
>
> (a) Operational and managerial standards. Each appropriate Federal banking agency shall, for all insured depository institutions, prescribe—
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> (1) standards relating to—
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> (A) internal controls, information systems, and internal audit systems, in accordance with section 1831m of this title;
> (B) loan documentation;
> (C) credit underwriting;
> (D) interest rate exposure;
> (E) asset growth; and
> (F) compensation, fees, and benefits, in accordance with subsection (c); and
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> (2) such other operational and managerial standards as the agency determines to be appropriate.

Some of the proposed Appendix does deal with internal controls and internal audits. But those aspects of the Appendix are not new in character. The diversity and stakeholder requirements are the core of what is new in the proposed Appendix and have nothing to do with the items listed in subsection (a)(1). Thus, upending state corporate law, introducing massive ambiguity and confusion with respect to bank board duties and potentially imposing race and gender-based diversity requirements on board composition must fall into subsection (a)(2), to wit, "such other operational and managerial standards as the agency determines to be appropriate."

There are two serious problems with that. First, you have the major questions doctrine 'hiding elephants in mouseholes' problem. Second, you have traditional statutory construction problems.

The proposed Appendix represents an unprecedented foray by the FDIC into corporate governance matters. Furthermore, the proposed Appendix would effectively overrule most state corporate law statutes by imposing a stakeholder requirement. This provision, in particular, fundamentally changes the nature of corporate board duties and it is very likely that a court will find that subsection (a)(2) is not enough to support a federalization of corporate law and dispensing with a least a century of state corporate law. There is little doubt that Congress did not intend such a result when it enacted the statute.

Furthermore, using traditional canons of statutory construction, a court should interpret (a)(2) in light of the purpose of section (standards for safety and soundness). The purpose of the section is not to impose stakeholder capitalism or implement Biden administration DEI initiatives.

Conclusion

This FDIC foray into corporate governance mandates is ill advised and not adequately considered. The proposed Appendix should be withdrawn. If the FDIC still believes that it is warranted to micromanage banks' corporate governance, then it should do so in a way that is based on facts, data, and evidence. That would entail at least three things. First, the FDIC Board and staff will actually have to engage with the corporate governance literature. Second, the FDIC should put out an RFI seeking input from academics, regulated institutions and the broader public about what constitutes good corporate governance, defining good corporate governance as corporate governance that furthers rather than hinders the safety and soundness of banks. Third, the FDIC will have to seriously analyze how its proposed rules interact with other federal and state corporate governance requirements and either conform its requirements to the existing requirements or provide some means of resolving the inconsistencies.

Sincerely,

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