

# Clarifying supervisory expectations for non-executive directors and boards

Bank Governance Leadership  
Network

April 2016



# Bank Governance Leadership Network ViewPoints

April 14, 2016

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## Clarifying supervisory expectations for non-executive directors and boards

There is not a strong consensus on how to set the expectations of Boards so that they can perform their role ... Demands on Non-Executives have risen to the point where it is time to stand back and take stock and find ways to improve the approach.<sup>1</sup>

– Andrew Bailey, Chief Executive Officer, Prudential Regulation Authority

Governance is now a cornerstone of supervision. A senior regulator stated, *“I have never seen a bank failure that did not have a governance and management problem at its root.”* As a result, another said, *“Boards are very important to supervisors.”* Since the BGLN began in 2009, participants have addressed core questions relating to bank governance: What is the role of the board, and what are appropriate expectations for bank non-executive directors? How can governance improve in the post-crisis world? How should supervisors understand and assess governance effectiveness? Many of these questions remain open. The task, then, continues to be reaching agreement on the role of a bank board and setting realistic expectations for what it can accomplish.

Despite supervisors’ efforts to develop new guidance at the national and international level, they acknowledge the role they have played in questions about what heightened supervisory expectations for bank directors mean in practice and whether there should be a global standard for board governance of systemically important financial institutions (SIFIs). This is not simply academic. Given the focus of politicians and regulators on board and individual accountability in banking, a lack of clarity regarding responsibilities is problematic.

Over the last several months, directors and supervisors shared perspectives on expectations for bank boards and directors, including roundtable discussions, on February 10th in New York, and on February 18th in London. These roundtables brought together directors and executives from 20 global banks and senior supervisors from nine regulatory authorities. [\[See Appendix on page 15 for a list of discussion participants.\]](#)

These discussions yielded some common themes, and some new insights, including observations regarding where consensus has emerged and where issues remain, and then offers some implications and recommendations for supervisors and bank boards and executives, summarized in the following sections:

- **Bank directors accept heightened expectations**
- **Some questions, confusion, and concerns persist regarding expectations for bank directors**
- **Supervisors can take practical steps to clarify expectations**
- **Boards need to retain ultimate responsibility for effectiveness**

### Bank directors accept heightened expectations

Directors recognize the complexity of risks in large banks, and the externalities associated with the potential failure of these institutions. Despite differences in governance and legal structures and historical precedent in different countries, all large bank boards are experiencing rising expectations. It is increasingly common therefore, for bank directors to spend significantly more time than is typical of directors in other industries. Still, some continue to question how much is being driven by the requirements of effective board governance and how much is being driven by supervisors.

### The gap between supervisory expectations and those of directors has narrowed

In response to what was seen as lax governance in some banks before the financial crisis, supervisors' expectations of bank directors has been increasing. As far back as 2010, participants discussed the increasing divergence between bank directors, who generally defined their role as one of oversight, and supervisors, who were increasingly pushing boards toward more direction and control (terms often used in governance codes). Subsequent BGLN discussions in 2012 on how supervisors can assess governance effectiveness concluded that developing a shared understanding of the role and expectations of the board is essential. A supervisor stated, "*Success would be agreement on what boards should be doing.*"<sup>2</sup> Nearly four years later, however, participants say the implicit expectations for bank NEDs remain unclear.

Yet, what has become clear, despite continued concerns from some directors, is that the expectations directors have for their role and those of supervisors are not that different:

- **Directors acknowledge that fulfilling their duty of care requires heightened engagement.** Because a SIFI's failure can impact the entire economy, boards of those institutions have a heightened duty to ensure they are prudently managed. A supervisor suggested, "*In the same way we have higher capital standards for SIFIs, we could have higher expectations for board directors.*" A director said, "*I start with the premise that these are complex industries that are multi-jurisdictional, and a learned understanding of the risks is difficult. I'm going to do a lot more than what the Delaware law says about duty of care. How could you possibly even cycle through all these issues with only four meetings a year?*" Another director likened serving on a bank board to being on two corporate boards. Ultimately, a number of participants agreed with the sentiment expressed by a director who stated, "*The fundamental duty of care is the same as on any board, but the complexity of financial institutions, and their heightened regulation, means*

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*"In the same way we have higher capital standards for SIFIs, we could have higher expectations for board directors."*

- Supervisor

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*that to do your job you need to spend more time to fulfill that duty of care. It is that simple.”*

- **The time commitment is significantly higher than for other corporate boards.** In general, directors accept that heightened expectations relative to other corporate boards means spending more time fulfilling their duties. They report spending significantly more time on a bank board than on other corporate boards, including the boards of other financial services companies (e.g., insurers, asset managers). Participants report spending two-to-five times as much time on large bank boards as they spend on other boards, even boards of other large multinational companies. Several said that as much as 100 days a year is not uncommon, especially for committee chairs. Most suggest 60 days or more is common even for “typical” bank directors, i.e., those who do not chair a committee. Several chairmen said they set clear expectations regarding the time commitment when recruiting new directors. One director said, *“Directors sitting on a board have to tell new recruits it is at least times two. If you are sitting on both the risk and audit committee, it is more than two times. If you agree to chair a committee, it is way more than a factor of two.”*

### **Drivers of heightened time and engagement requirements are the complexity of the businesses and risks involved in large, international banking institutions**

While they do see the cumulative impact of supervisory requests as having a significant impact on board agendas, in general, directors did not point to minutiae being pushed to the board by supervisors as a significant driver of increased time spent. When asked directly, many directors struggled to identify specific issues that supervisors were explicitly or implicitly asking them to devote time and attention to that they would not otherwise be focused on. What they describe instead is a combination of regulatory-driven initiatives, risk oversight, and strategic challenges taking up their time. A director observed, *“The complexity of the operating environment is taking a lot of time and it is driven by the global regulatory agenda.”* The issue is more one of calibration: how much time and attention and at what level of detail should boards be spending on those things that are deemed important to the bank by both boards and supervisors?

### **Variance in practices and perspectives do persist**

Despite a growing consensus that the expectations for bank boards and directors are rightly higher than in the past, or the norm for other companies, there still remains wide variance in perspectives regarding what the appropriate level of engagement should be. For example, not all directors think 100 or even 60 days a year is necessary or reasonable, so there remain variances in practice. The variables impacting how much time individual directors spend on their duties include: personal experience (e.g., financial services background or not); level of external pressure for engagement (e.g., pressure from regulators or shareholders); and the issues facing the institution (legacy and current regulatory issues, financial strength and performance, and degree of strategic change currently underway).

Some directors are questioning whether expectations, at least in part driven by supervisors, are pushing bank boards into a level of engagement that is unprecedented for non-executive directors, challenging the traditional notion of board oversight. One director asserted, *“Bank boards are being asked to conduct themselves at a different standard than other companies ... That may mean different people on boards, paid differently, with support staff, etc. That is a different model than the one that has existed, and the one we’ve got is being stretched to the breaking point. You can have a different kind of board, but let’s not pretend you can do it under the old model.”*

### **Banks may now be at the forefront of a broader trend toward more engaged boards**

Some participants actually suggested that the level of engagement of bank directors may be at the forefront of a model of good governance. In other words, perhaps there is indeed a different governance model that is emerging for bank boards that needs to be acknowledged explicitly. A director suggested, *“Given all the focus on governance since the crisis, I think bank boards are now at the cutting edge of governance. It may be a model that others will follow.”* Another director agreed that this trend is not so much a cyclical change in banking, but more likely a longer-term shift in governance: *“I think we will see more boards outside financial services move in our direction than banks revert back to the kind of expectations for boards common prior to the crisis.”*

### **Some questions, confusion, and concerns regarding supervisory expectations persist**

While there is a broadly shared view that more engaged boards, spending more time and developing a deeper understanding of the business models and risks in their institutions is reasonable, these discussions highlighted areas for improvement.

### **Supervisors do not distinguish clearly between board and management responsibilities**

If directors are pushed to spend more time and be more deeply engaged in the operations and management of banks, they risk losing independence and crossing the line into management responsibility. When asked, *“Are there decisions you expect management to take without the board involved? Have there been issues where you didn’t hold the board responsible? Is there a category of management only?”* supervisors struggled to provide examples. The failure to distinguish between the roles and expectations for boards and management remains a significant source of angst. This happens explicitly in formal rules, guidance, and regulatory letters that often use the term “the board and management ...” without distinguishing what is being asked of each group. One director stated, *“My primary objection is blurring the lines between the roles of the board and management ... Oversight and management are starkly different things.”*

The lack of differentiation suggests to some directors that supervisors see the board as ultimately *“responsible for everything”* that happens in the bank. One director complained, *“When something goes wrong, supervisors’ knee jerk reaction is that it*

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*“That is a different model than the one that has existed, and the one we’ve got is being stretched to the breaking point.”*

- Director

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*“My primary objection is blurring the lines between the roles of the board and management ... Oversight and management are starkly different things.”*

- Director

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*represents a failure of governance. Some trader breaks a rule and it means governance was not strong enough.*” This contributes to a sense that expectations are unrealistic, because the best governance, with the most effective board oversight, would not stop issues emerging, or losses or misconduct occurring. A supervisor acknowledged, *“We shouldn’t just point to governance, but instead what is the control breakdown? What is the root of the problem?”*

The lack of clear lines of responsibility between board oversight and management remains problematic for supervisors and for boards. For supervisors, this leads to inconsistent expectations across the industry, and even within supervisory organizations. A participant observed, *“The trend is to make the board responsible for everything and it is not right. I recognize there was a lack of accountability in some cases, but we need to get the balance right between nobody is responsible and the board is always responsible.”*

### **Supervisors are reluctant to be explicit**

Some supervisors questioned how much guidance directors really wanted from supervisors, and how specific that guidance should be. One supervisor confessed, *“Ex-ante, there is very little we can do. So, we tend to either overreact to a small problem as one of governance, or we remain vague when asked about expectations.”* Directors, not looking for prescriptive rules or even detailed principles about governance, do see some additional clarification from supervisors as helpful. One director said, *“Some guidance would be useful. There is a difference between guidance and principles or rules.”*

While a number of supervisors have produced additional guidance regarding governance and the role of boards in recent years, and others are in the process of updating their guidance, many recommended caution about being too explicit. One said, *“I would be cautious about supervisors, ex-ante, determining precisely what the roles of directors should be. Any subject should be within the board’s reach, without preempting the board’s responsibility for how it spends its time.”* Issues driving this caution include the following:

- **Room for flexibility.** Supervisors recognize that different practices can be equally effective. One said, *“It is tough to write guidance because we want flexibility on what fits with firms.”* Another supervisor noted that different situations may require different degrees and types of board involvement: *“Each situation is different. The fear is if you draw a bright line and it is not in the appropriate spot.”*
- **Board accountability.** As one supervisor said, *“Some of the history for why supervisory language migrated to both ‘the board and management’ is to make sure there was accountability for both. It was a reaction to past crises ... There shouldn’t be a safe harbor, but the expectations should still be reasonable and different for each actor.”*

Supervisory expectations have therefore tended to be defined implicitly in ways that can create confusion or create what are perceived as unrealistic expectations when added together. A supervisor acknowledged, *“The challenge with clarifying expectations is that*

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*“Some guidance would be useful. There is a difference between guidance and principles or rules.”*

- Director

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*“I would be cautious about supervisors, ex-ante, determining precisely what the roles of directors should be. Any subject should be within the board’s reach.”*

- Supervisor

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*we are still setting them ... I am not sure we have articulated them in the first place.”* They tend to be set via a combination of formal guidance, letters addressing specific issues calling for board attention, questions from supervisors (e.g., “Did this go to the board?”), or questions directed at NEDs about very detailed technical aspects of a particular issue.

All of this ambiguity leads to an accumulation of responsibilities over time. A director observed, *“Supervisors err on the side of more detailed knowledge and engagement. On any single issue this may look reasonable, but when you add up all the issues, there are not enough hours in the day.”* A supervisor acknowledged, *“A lot of it is creep ... We as the supervisory community need to be careful in our engagement with directors and executives when we bring up an issue ... We need to be careful about stealth expectations.”*

### **Lack of a shared, consistent understanding of key terms is problematic**

During one of the meetings, participants spent time parsing language used in documents and in discussion about the role of the board. Why? Because words like “approve,” “ensure,” “own,” “review,” and “oversight,” are commonly used, including in regulations and supervisory guidance, but are all open to interpretation. That means broad agreement on the role of the board in general terms still leaves room for a wide range of expectations as to what that means in practice.

One participant asserted, *“That is the key, critical thing. What do those words mean? It is the central crux of the discussion.”* Another asked, *“What is actually expected of the board? What does it mean that the board must approve a 10,000 page resolution plan? Read it?”*

### **Increasingly specialized, professional directors**

Different expectations for different directors are increasingly being set implicitly, and explicitly in some cases, such as via the United Kingdom’s Senior Manager’s Regime, which identifies specific responsibilities for directors covered by the regime: chairmen, audit, and risk committee chairs.<sup>3</sup> These differentiated expectations raise questions about group as opposed to individual accountability. Some have referred to the creation of *“super directors,”* as a result.

A mix of skills and experience is necessary for an effective board. But sitting executives, particularly CEOs, who can bring a valuable strategic or customer perspective, cannot possibly devote as much as 100 days per year to the role. Others, such as the chairman and key committee chairs (risk and audit in particular), often spend much more time and have a deeper understanding of some key issues than other directors. Also, as bank boards look to attract people with the skills that are increasingly relevant and important – the most obvious being technology-related skills such as digital and cybersecurity expertise – those directors may not have banking, financial services, or risk expertise. That means increasingly differentiated roles and expectations. A director stated, *“Not everyone on this board could be risk committee chair.”*

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*“What is actually expected of the board? What does it mean that the board must approve a 10,000 page resolution plan? Read it?”*

- Participant

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Participants noted the value they place on each board seat as they seek to limit the size of boards to between 14 and 18 people. This constraint further emphasizes the importance of clarity regarding expectations: what level of technical detail should the board necessarily delve into to effectively fulfill their responsibilities? What expertise is required to do that effectively? While many support the idea of bringing on additional expertise, others note the limitations to developing increasingly specialized directors. One participant said, *“There is no limit to the expertise we can access and consult, but there is a strict limit to the number of people we can put on the board.”* Some boards are experimenting with ways to bring external perspectives into the boardroom. One board added external advisers to board committees, while another is considering creating a technology advisory board. These approaches bring expertise without adding individuals to the board who bear the full responsibility of directors.

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*“There is no limit to the expertise we can access and consult, but there is a strict limit to the number of people we can put on the board.”*

- Participant

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A director said, *“There is a real concern in the UK about the disappearance of collective responsibility. If we bring in a digital director, for example, then we can take a step back from those issues. The regulators are saying the Senior Managers Regime doesn’t change collective responsibility, but the fact they are having to say it concerns me.”* But another director shared a different perspective: *“To me the risk of over-delegating our collective responsibility is less of a concern than not providing effective challenge via the use of specialists. I want every member of my audit committee to specialize. I have one board director who is dramatically deeper on [anti-money laundering] issues than everyone else and that is a good thing.”*

### **Risk to personal reputations is among the top considerations for joining a bank board**

Some supervisors and directors wondered whether banks faced a real challenge in attracting and retaining the kind of directors they need as result of heightened expectations and accountability. Some directors said banks are facing a *“crisis”* for recruiting qualified directors. For the first time, some executives and directors report candidates turning down offered directorships. Yet, others said they have had no difficulties with recruiting. Supervisors who vet directors also said they had not witnessed a decline in the quality of director candidates.

It is clear that the role is challenging, and that the issues in the banking sector in recent years – ranging from conduct-related fines and litigation to strategic risks and ongoing recovery from near-failure – mean that in the words of one director, *“The risk is clear and present, while the reward is not so clear.”* Some directors expressed concern that no matter what steps they take, changing standards over time will create future liability. One stated, *“Hindsight will always judge harshly, and it does not expire. We face almost unlimited future liability from a personal reputation perspective.”* Participants acknowledged that *“no amount of definition or clarity will provide safe harbor,”* and therefore directors’ *“actions need to stand the test of time.”* But another director noted, *“The fact is if you look at something from five years ago that went wrong, the microscope goes in on that one decision ... You may have agreed the process was right back then, yet*

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*“Hindsight will always judge harshly, and it does not expire.”*

- Director

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*we run risk businesses. You are always going to be looking back at something that has gone wrong rather than having a discussion of whether the process was right.”*

#### Examples of issues where directors say expectations are unclear

Examples are helpful, and illuminating, when discussing expectations and reasonable actions for boards to take to fulfill their responsibilities. Below are some areas where directors raised questions as to what supervisors expected of boards:

- **Culture.** Participants questioned what it means to suggest the board “owns” culture, a topic that has garnered significant board and supervisory attention in recent years. One director said, “Boards would agree they own culture and so does the CEO. What is really important is the board’s role in making sure the culture is appropriate, is different than the CEO’s role. To just say the board owns culture doesn’t help me.” Another said, “The board would have responsibility to discuss it frequently and whether a company is making progress, but that is not to confuse it with responsibility for culture.”
- **Model governance.** Because of the central importance of models in risk and capital considerations in banks, and the risk in getting the assumptions wrong, model governance has become a focus for supervisors. A director said, “The whole issue around models and model controls concerns me. How does a board member discharge responsibility over thousands of models? ... The level of knowledge to understand these models and to assess if they are working properly without being a programmer is impossible.” But a supervisor suggested the role boards can play is reasonable, saying, “Did you do back testing on the models? What are the governance procedures? How often are they tested by the model validation group? What is the role of internal audit? What is your whole infrastructure? ... We don’t expect board members to test the model. We expect appropriate governance around the model.”
- **Technology and cybersecurity.** Oversight of technical issues, such as risk data aggregation – particularly given the focus of supervisors on compliance with the Basel Committee on Banking Supervision (BCBS) 239 – and cybersecurity. These are issues that require board attention, but raise questions regarding the board’s ability to effectively “ensure” their institutions are taking the right steps. A director said of cybersecurity, “You can ask what management is doing, if you have the right firewalls, or employ ethical hackers, etc., but it is almost impossible to prevent an attack. What more can a board do to really press or help management?” Another said, “Is the risk identified? What is being done to monitor and mitigate it? I don’t think boards should go beyond that.”

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*“The whole issue around models and model controls concerns me. How does a board member discharge responsibility over thousands of models?”*

- Director

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*“Is the risk identified? What is being done to monitor and mitigate it? I don’t think boards should go beyond that.”*

- Director

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### Examples of issues where directors say expectations are unclear contd

- **Resolution planning.** One participant noted, *“Resolution planning was a test case with very detailed documents, but I am not sure what the value add of directors really is. A supervisor went on to say, “It is not by having someone give you 40,000 pages, but by engaging in a dialogue on the important aspects of the document so that the process is sound and you don’t have to look for the needle in the haystack.”*

### Supervisors can take practical steps to clarify expectations

While supervisors remain hesitant to develop detailed, specific, or prescriptive guidance regarding their expectations for board oversight, these discussions suggest that there are meaningful steps supervisors can take to clarify what they expect of boards. Supervisors should consider the following steps:

- **Focus on national solutions.** Given differing legal and governance structures, and different stages of maturity among supervisors regarding governance expectations, engagement with boards, and efforts to assess effectiveness, accomplishing agreement on expectations on an international basis is challenging. A director observed, *“These things are very local. Governance is quite culturally based. The practices in one country may not work elsewhere. Developing one rule in multiple places would be quite difficult.”* Given the international operations of large banks, and the focus on subsidiary governance, some internationally-shared view of expectations would be ideal. But progress is possible only if supervisors and regulators within countries have a shared view first.
- **Avoid “lazy use of language.”** As noted, the lack of a clear definition for terms that are used to define board and director responsibilities is in many ways the crux of the challenge. While these discussions demonstrated the difficulties in avoiding the use of or clearly defining words like “approve,” and “ensure,” there is room for supervisors to be more careful with the language they choose and clarify what they are asking boards to do in context.
- **Develop more explicit definitions of expectations.** A supervisor said, *“Painting a picture of what good looks like is important for directors and supervisors.”* These conversations highlighted the challenges and pitfalls in attempting to provide crisp descriptions of expectations or in setting specific requirements. Still, a director stated, *“Additional guidance on a case-by-case basis would be a big step forward. It would remove a lot of ambiguity. If you struggle to avoid creating the problem with the words used in guidance, then the workaround is the extra paragraph providing clarity.”* Providing additional guidance on a case-by-case basis can be helpful, but it must be supported by at least a broad description, and a shared understanding among supervisors, of the role and expectations of boards vis-à-vis management. The work among the banks and the Office of the Superintendent of Financial Institutions (OSFI) in Canada was

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*“Additional guidance on a case-by-case basis would be a big step forward. It would remove a lot of ambiguity.”*

- Director

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highlighted as effectively addressing some of these questions through updated governance guidelines that included a single paragraph that defined the role of the board.<sup>4</sup>

- **Use specific examples as case studies.** Supervisors and directors suggested that talking through what should be expected of boards regarding specific issues would be a helpful exercise (again, model approvals, oversight of cybersecurity, and BCBS 239 were offered as examples). This would also offer an opportunity for supervisors to provide some benchmarking of practices relative to peers. While some supervisors are hesitant to share “best” or even “good” practices, participants suggested they can at least identify where institutions may be outliers. A supervisor said, *“We have no grounds to regulate you to best practice. Just that you are adequate. We will give feedback to firms on broad practices and point out where they are not adequate.”* Another shared a similar view, saying, *“One of our value adds as supervisors is our ability to look across an area or product and tell you if you are falling out of the range.”*
- **Prioritize issues for board attention.** Directors emphasized that they believe they should focus on key drivers of profitability and the risks to that profitability. Several participants suggested better coordination between boards and supervisors must be possible in order to agree on the core areas that the board should be focusing on, which will allow boards to limit, as appropriate, things being sent to the board. One director suggested asking, *“Does this enhance the ability of the board to effectively do their job?”* when pushing things to their attention. A director said, *“I have a fixed amount of time for board meetings. I have to decide priorities and how to allocate scarce resources. As supervisors, I’d look at how allocations line up with major challenges of the banks.”*
- **Candidly discuss expectations on an ongoing basis.** In each discussion, participants returned to the importance of candid, informal discussions between directors and supervisors. In some ways, this is as simple as one supervisor’s suggestion that if directors are unclear regarding supervisors’ expectations, *“call your supervisor and discuss it.”* Ultimately, so much of this is subjective, nuanced, and difficult to quantify. It is important to build trust and get the tone right to allow for candid exchange, including constructive pushback from directors. *“We are meeting more with directors even if we have nothing specific to discuss, because it creates a space for them to bring things up. We look to things like: Is the board aware of the risk inherent in their business model? Is management being proactive in looking for practices to compare and contrast with their own firm?”* A supervisor suggested, *“Over the course of time, through an ongoing dialogue is really the way you perceive effectiveness.”* Another supervisor supported this approach: *“I think directors are more interested in a continuous dialogue with supervisors rather than explicit descriptions up front.”*

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*“We have no grounds to regulate you to best practice. Just that you are adequate.”*

- Supervisor

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- **Engage with boards at appropriate levels of seniority and experience.** Junior supervisory staff typically lack firsthand experience in boardrooms, and therefore are perceived as lacking knowledge about how effective governance works. A director asserted, *“Supervising teams feel it is their job to judge governance with no real understanding of how the board operates.”* This is a common refrain from directors. Some are genuinely uncomfortable with spending time being questioned and assessed by those they perceive to be inexperienced supervisors who do not understand how boards function in practice. Another common critique is that the views of senior supervisors do not always translate into consistent messages with supervisors with which the bank interacts more frequently, a situation compounded by the lack of a clear definition of the role and expectations of the board. To build trust and candor requires a commitment from senior supervisors and directors to engage directly. One supervisor noted that they are now using senior advisors for governance assessments and board engagement in an effort to address these concerns. A supervisor observed, *“Supervision demands a lot of technical and interpersonal skill. You need to get very strong egos to change their minds and do something different ... Here, supervision is very distinct from regulation. It is a matter of judgment ... We should spend more time developing supervision and supervisors.”*
- **Avoid an excessive focus on documentation.** A supervisor acknowledged, *“When we can’t find evidence, we assume it never happened. We can act like that sometimes.”* Reviewing board minutes, which vary substantially across markets and banks in their level of detail, doesn’t necessarily demonstrate effective governance, or lack thereof. Furthermore, some directors suggest that a focus on creating *“an audit trail”* of evidence can result in distraction, pushing real dialogue further outside of formal forums and contributing to a fear of a legalistic approach, which could ultimately hamper candid challenge and exchange. A director asserted, *“The board minutes are irrelevant, it is about the influence the directors have on the discussion,”* and another argued, *“If they ask us to put something in the minutes then the whole process becomes artificial. It would require a full accounting of how we got to a decision.”* A regulator observed, *“The board minutes are interesting, but they are a small piece of the pie. I care more about how you come to the decision. The evolution over time.”*

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*“Supervision demands a lot of technical and interpersonal skill. You need to get very strong egos to change their minds and do something different.”*

- Supervisor

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*“When we can’t find evidence, we assume it never happened. We can act like that sometimes.”*

- Supervisor

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### Boards need to retain ultimate responsibility for their effectiveness

These discussions were focused on clarifying supervisory expectations for boards and directors. Yet, they also highlighted that supervisors are not looking to create prescriptive expectations for boards. Instead, they expect boards to conduct themselves in a manner that would satisfy a reasonable expectation for good governance. This keeps the onus on boards to determine how best to fulfill their duties and to describe to supervisors why they believe they are effectively executing their role.

### **The board still has ultimate discretion as to how they fulfill their duties**

Boards and management retain responsibility for how the board spends its time and fulfills its duties. For the most part, the board has discretion as to how it addresses relevant issues, even when the supervisor expects or explicitly requests board attention on something. Often, management asks the board to review things, suggesting that supervisors had requested it. Boards and management can do a better job of identifying what needs board attention and what specifically supervisors are requesting, while seeking additional feedback from supervisors as to what they expect from the board.

Boards also need to respond when they feel they are being pushed into things that are not realistic or within reasonable expectations for non-executives and discuss with supervisors perceived differences of opinion. As one board member stated, *“If we are being asked to chase the wrong rabbit down the wrong hole, we simply won’t spend much time on it.”*

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*“[Reporting] needs to explain what risks were taken, what are the tails, so the board can make a decision.”*

- Participant

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### **Management needs to find ways to improve reporting to the board**

The amount of information the board is expected to review is substantial and contributes to the idea that boards need to spend a lot of time delving into details. A participant asked, *“Why does management feel the need to give the board 2,000 pages to discharge their responsibility of transparency to the board? The link is broken if management feels this amount of information is needed so that they can’t be blamed for the board not seeing something.”* Another stated, *“The data dump is not going to produce good governance ... [Reporting] needs to explain what risks were taken, what are the tails, so the board can make a decision.”*

While there is risk in management filtering too much information to the board, a participant asserted, *“It is part of the governance architecture. Management has the responsibility to provide information in a timely and actionable way ... They need to produce a document that is actionable from the board point of view.”* Another participant went on to describe what this means: *“I would substitute the word information for insight. I want insight, which means words. There should be a narrative around it. And the information coming to the board should be coming from the perspective of the second line of defense; they should provide commentary. The board can then more quickly get to the real issues.”* Andrew Bailey, CEO of the UK Prudential Regulation Authority, said in a speech, *“It is the job of the Executive to be able to explain in simple and transparent terms these complex matters to Non-Executives. In doing so, you should understand the uncertainty around judgements, in what circumstances they could be wrong, and how there can reasonably be different ways to measure things like liquidity. Non-Executives should not be left to find the answers for themselves ... In other words, they should not be pointed towards the haystack with warm wishes for the search ahead.”*<sup>5</sup>

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*“I find regulators have an obsession with the term ‘constructive challenge.’ There is a wide gap between supervisors and NEDs on what this means in practice.”*

- Director

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### **Directors need to be prepared to explain and demonstrate governance effectiveness**

A number of directors bristled against spending a lot of time demonstrating what they did and documenting for supervisors what they describe as a *“complex decision-making process.”* As noted above, they are also concerned about the *“slippery slope”* of focusing

on documentation, creating “an audit trail” for every conversation that is part of the governance process. Directors suggest misperceptions of how governance works persist among some supervisors. For example, one director said, *“I find regulators have an obsession with the term ‘constructive challenge.’ There is a wide gap between supervisors and NEDs on what this means in practice. The regulatory view is unrealistic and some of it is the fault of NEDs not explaining how we do that challenge. We like to be constructively annoying, but we don’t always have a document proving it.”*

If supervisors are to gain insight into the nuanced governance processes in different institutions, directors have a responsibility to spend the time explaining their approaches. Throughout the two meetings, there was tension between those suggesting supervisors should not be overly concerned with process (e.g., *“The sausage-making is relevant, but it is not really that important relative to the ultimate judgment.”*) and those suggesting supervisors should primarily be concerned with process, rather than assessing whether the ultimate judgment is a good one or not (*“Directors want a performance standard focused on what they do, not so much the outcome,”* or *“How does the board demonstrate it had the right set of considerations to make the approval warranted?”*) Regardless, if formal documentation is ineffective and raises concerns, then directors and executives should be prepared to describe to supervisors how decisions were reached, educate less experienced supervisors as to how the governance process works in their institution, and describe how they ultimately get comfortable with decisions.

A supervisor described the challenge they face: *“We have the problem in assessing governance of the problem of false positives. If we look at outcomes instead of inputs, what does good look like?”* Another observed, *“Directors often tell us what effective challenge isn’t, but then what is it? Can directors share what it looks like?”*

★★★

One director encapsulated the challenge of setting clear expectations for bank boards and directors: *“We want directors to be independent, yet highly committed and dedicating a lot of time. There is a requirement of banking knowledge, yet we also need board members from outside of banking ... Then there is a push for smaller boards, but we should have the full set of qualifications and expertise needed. Lastly, directors are supposed to provide independent challenge, but also avoid being intrusive to management. It is full of contradictions.”* These discussions, part of a continuing dialogue among bank directors and supervisors, made clear that there is no easy solution to clarifying supervisory expectations for bank directors. Yet, they also suggest that the gap between supervisory definitions of effective board governance and those of directors are, for the most part, not much different. Small steps and ongoing discussion between boards and supervisors will further clarify the emerging model and expectations for bank governance.

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*“We have the problem in assessing governance of the problem of false positives. If we look at outcomes instead of inputs, what does good look like?”*

- Supervisor

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## About the Bank Governance Leadership Network (BGLN)

The BGLN addresses key issues facing complex global banks. Its primary focus is the non-executive director, but it also engages members of senior management, regulators, and other key stakeholders committed to outstanding governance and supervision in support of building strong, enduring, and trustworthy banking institutions. The BGLN is organized and led by Tapestry Networks, with the support of EY. *ViewPoints* is produced by Tapestry Networks and aims to capture the essence of the BGLN discussion and associated research. Those who receive *ViewPoints* are encouraged to share it with others in their own networks. The more board members, senior management, advisers, and stakeholders who become engaged in this leading-edge dialogue, the more value will be created for all.

## About Tapestry Networks

Tapestry Networks is a privately held professional services firm. Its mission is to advance society's ability to govern and lead across the borders of sector, geography, and constituency. To do this, Tapestry forms multi-stakeholder collaborations that embrace the public and private sector, as well as civil society. The participants in these initiatives are leaders drawn from key stakeholder organizations who realize the status quo is neither desirable nor sustainable, and are seeking a goal that transcends their own interests and benefits everyone. Tapestry has used this approach to address critical and complex challenges in corporate governance, financial services, and healthcare.

## About EY

EY is a global leader in assurance, tax, transaction, and advisory services to the banking industry. The insights and quality services it delivers help build trust and confidence in the capital markets and in economies the world over. EY develops outstanding leaders who team to deliver on our promises to all of our stakeholders. In so doing, EY plays a critical role in building a better working world for its people, for its clients and for its communities. EY supports the BGLN as part of its continuing commitment to board effectiveness and good governance in the financial services sector.

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## Appendix: discussion participants

In February of this year, Tapestry and EY hosted two BGLN meetings on clarifying supervisory expectations for bank boards and non-executive directors and had over 35 conversations with directors, executives, regulators, supervisors, and other thought leaders. Insights from these discussions informed this *ViewPoints* and quotes from these discussions appear throughout.

The following individuals participated in BGLN discussions:

### Bank directors and executives

- Domingo Armengol, Corporate Secretary and Secretary of the Board of Directors, BBVA
- Lord Norman Blackwell, Chairman and Nomination and Governance Committee Chair, Lloyds
- David Cannon, Audit Committee Chair, Morgan Stanley International
- Sir Sandy Crombie, Senior Independent Director and Performance and Remuneration Committee Chair, RBS
- Sir Howard Davies, Chairman and Nominations and Governance Committee Chair, RBS
- Noreen Doyle, Vice-Chair, Lead Independent Director, Credit Suisse
- Dina Dublon, Risk Committee Chair, Deutsche Bank
- Tim Flynn, Non-Executive Director, JPMorgan Chase
- Morten Friis, Non-Executive Director, RBS
- Byron Grote, Non-Executive Director, Standard Chartered
- Brian Levitt, Chairman of the Board and Corporate Governance Committee Chair, TD Bank
- Rachel Lomax, Senior Independent Director and Conduct and Values Committee Chair, HSBC
- Scott Moeller, Risk Committee Chair, JPMorgan Securities
- Tom O'Neill, Chairman of the Board, Scotia Bank
- Louise Parent, Non-Executive Director, Deutsche Bank
- Jim Quigley, Audit and Examination Committee Chair, Wells Fargo
- Alexandra Schaapveld, Audit and Internal Control Committee Chair, Société Générale
- David Sidwell, Risk Committee Chair, UBS
- Katie Taylor, Chair of the Board, RBC
- Perry Traquina, Non-Executive Director, Morgan Stanley
- Tim Tookey, Risk Committee Chair, Nationwide Building Society
- François Veverka, Audit Committee Chair and Risk Committee Chair, Crédit Agricole
- Alexander Wolfgring, Internal Controls & Risks Committee Chair, UniCredit

### Regulators, supervisors, industry groups

- Gary Barnett, Deputy Director, Division of Trading and Markets, US Securities and Exchange Commission
- John Beebe, Risk Advisor, Federal Reserve Board of Governors, Federal Reserve System
- Jan Blöchliger, Supervision of Credit Suisse Group, Banks Division, FINMA
- Stephanie Chaly, Assistant Vice President, Financial Institution Supervision Group, Federal Reserve Bank of New York

- Violaine Clerc, Deputy Director, Bank Supervision (Directorate 1), ACPR
  - Margarita Delgado, Deputy General, Micro Prudential Supervision I, ECB
  - Christer Furustedt, Head, Large Bank Supervision Department, Financial Services Agency Sweden
  - Jim Hennessy, Senior Vice President and Chief of Staff, Federal Reserve Bank of New York
  - Jamey Hubbs, Assistant Superintendent, Deposit-Taking Supervision Sector, Office of the Superintendent of Financial Institutions
  - Ann Misback, Associate Director, Division of Banking and Regulation, Federal Reserve System
  - Lyndon Nelson, Executive Director, UK Deposit-Takers Supervision, Bank of England
  - Bruce Richards, Senior Vice President and Head of the Complex Financial Institutions, Federal Reserve Bank of New York
  - Kevin Stiroh, Executive Vice President and Head of the Financial Institution Supervision Group, Federal Reserve Bank of New York
  - Masaaki Tani, Deputy Director, Business Management Monitoring Team, Inspection Bureau, Financial Services Agency Japan
  - Gisella van Vollenhoven, Director, On-site Supervision and Banking Expertise, De Nederlandsche Bank
  - Kevin Walsh, Deputy Comptroller for Market Risk, Office of the Comptroller of the Currency
- EY**
- Andy Baldwin, EMEIA FSO Regional Managing Partner
  - Ted Price, Senior Advisor, Risk Governance
  - Marc Saidenberg, Principal, Financial Services
  - Isabelle Santenac, EMEIA FSO Assurance Managing Partner
- Tapestry Networks**
- Dennis Andrade, Partner
  - Jonathan Day, Vice Chairman
  - Colin Erhardt, Associate

## Endnotes

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- <sup>1</sup> Andrew Bailey, “[Governance and the Role of Boards](#)” (speech at the Westminster Business Forum, London, November 3, 2015), 3, 5.
- <sup>2</sup> Bank Governance Leadership Network, [Understanding and Assessing Governance Effectiveness: A Challenge for Supervisors](#), *ViewPoints* (Waltham, MA: Tapestry Networks, 2012), 3.
- <sup>3</sup> For more about the Senior Managers Regime, see “[Strengthening Accountability: Latest News](#),” Bank of England, Prudential Regulation Authority, update March 7, 2016.
- <sup>4</sup> The following material, from [OSFI Corporate Guideline, January 2013](#), was offered as a useful statement regarding board expectations: “The Board should understand the decisions, plans and policies being undertaken by Senior Management and their potential impact on the [institution]. It should probe, question and seek assurances from Senior Management that these are consistent with the Board-approved strategy and risk appetite for the [institution], and that the corresponding internal controls are sound and implemented in an effective manner. The Board should establish processes to periodically assess the assurances provided to it by Senior Management. The Board is not responsible for the on-going and detailed operationalization of its decisions and strategy. These should be matters for Senior Management to consider. While Senior Management should have regular interaction with regulators with respect to the overall operations of the FRFI, the Board should ensure that regulators are promptly notified of substantive issues affecting the FRFI.”
- <sup>5</sup> Bailey, “[Governance and the Role of Boards](#),” 4.