IBC

International Bancshares
Corporation

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Via Electronic Submission: regs.comments@federalreserve.gov

Robert deV. Frierson, Secretary
Board of Governors of the Federal Reserve System
20th Street and Constitution Avenue NW
Washington, DC 20551

RE: Proposed Guidance on Supervisory Expectations for Boards of Directors, Docket No. OP-1570

Dear Mr. Frierson:

Thank you for this opportunity to comment on the proposed guidance from the Board of Governors of the Federal Reserve System (Federal Reserve) regarding supervisory expectations for boards of directors. I am the Chairman and CEO of International Bancshares Corporation (IBC) (NASDAQ: IBOC), a Texas bank holding company with financial holding company status headquartered in Laredo, Texas. The first IBC Bank was founded in 1966 to meet the needs of small businesses in Laredo, Texas, and now, more than 50 years later, IBC is the largest Hispanic financial holding company in the continental United States, with approximately $12 billion in assets and five separately chartered subsidiary banks.

I am providing these comments on behalf of IBC, which takes a strong interest in this important corporate governance issue. We appreciate the Federal Reserve's decision to issue this proposal for public comment before issuing final guidance. We believe the following issues should be considered as part of that process with regard to the expectations of boards of directors for financial institutions of any size. We are not commenting specifically on the aspects of the proposal that would cover only the largest financial institutions.

The Appropriate Role of the Board of Directors

First, as a general matter, as the Federal Reserve acknowledges in the proposal, regulators' supervisory expectations regarding directors' roles have grown considerably over the years. Indeed, they have expanded to an extent that, at times, seems to conflate the role of directors with the role of management.

Not only does this set an unrealistic standard, it also takes away from directors' ability to focus on their core responsibilities rather than on micromanaging officers and the day-to-day business of the institution. On a practical level, at IBC and its subsidiary banks, this has resulted in board meetings lasting many hours as directors wade through minutiae that could more properly be left to management. Our directors' briefing books now consist of multiple volumes; for directors to

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simply read this material, let alone understand it in depth, takes an extremely long time. While we at IBC certainly expect a high level of involvement and time commitment from our directors, that involvement and commitment could be better spent giving more in-depth attention to matters more squarely in the province of boards, such as overseeing risk management and controls, and evaluating the performance and compensation of executive management. With a finite amount of time to spend on board meetings, these core board matters must share the agenda with the array of other matters that have been added to directors' plates over the years.

Certainly, directors' responsibilities should not be watered down to a degree where their involvement is no longer helpful to the institution. Directors should always continue to play a central role in the safe, sound, and compliant operation of a financial institution. But to effectively carry out that role, directors must be able to focus on that role and not be required to also perform the duties of management.

As a general matter, then, we support the Federal Reserve's proposal to revise, in many instances, references in guidance to obligations on "the board and senior management" to instead refer to "senior management" only. We stress that this would not mean that the board would have no involvement in or knowledge of the matter. Rather, the board would evaluate the performance of management in carrying out that specified obligation.

Outside Directors

We also want to point out that the ever-increasing expectations of directors fall acutely on independent directors. By their nature, these directors are not part of management, and thus have no power to execute the day-to-day business of the financial institution, and are not privy to the granular details of the institution's everyday operations, as someone carrying out those operations would be. Yet, from a supervisory perspective, it often appears that is precisely what regulators expect.

In the proposal, the Federal Reserve speaks generally of directors' roles and does not distinguish between inside and outside directors. In any final guidance, we encourage the Federal Reserve to recognize that outside directors do not have the management-level information and power that inside directors (from their capacity as institution employees) possess. While this does not mean that outside directors should be held to a different or lower standard, it does mean that it is unrealistic to expect management-level involvement of any director in his or her capacity as a director.

Therefore, it would be helpful to hear from the Federal Reserve that the agency understands and acknowledges this limitation on outside directors. Under current supervisory approaches, it can seem that regulators — not only the Federal Reserve — presume that directors are also officers. It would be helpful to have an explicit acknowledgement that not all directors are financial institution employees, and that directors of any type are not expected to perform the role of management.

We should also not forget that many small and medium-sized institutions recruit directors from their communities; these directors serve a community responsibility to promote the economic and social welfare of the cities and towns they call home. Most put in many hours and receive modest compensation. Because of the time required due to additional demands by the regulators, these directors are being tasked to fill a management role instead of an oversight and overall leadership role. Because of the lack of qualified directors in many smaller communities, financial institutions are left helpless to fill these director positions. It is important to understand that there is an America outside Washington, D.C. that financial institutions and their directors serve.

Specific Questions Asked in the Proposal

We also want to provide feedback on the following two questions the Federal Reserve asks in the proposal.

- *Question (5): Is the proposed guidance on the communication of supervisory findings clear with respect to the division of responsibilities between the board and senior management?*

  As a general matter, we support the proposal's treatment of the communication of supervisory findings. In particular, we appreciate the Federal Reserve's willingness to establish that acting on Matters Requiring Attention (MRAs) and Matters Requiring Immediate Attention (MRIAs) generally should be the province of management, except for an MRA or MRIA that sets forth an action to be taken by the board of directors.

  We do request a clarification in the guidance's discussion of MRAs and MRIAs. Specifically, we request that the Federal Reserve clarify that directors should, as a general practice, be provided with access to MRAs and MRIAs, as well as to Reports of Examination and other supervisory reports, for their reference, even while the onus to act on such findings is the province of management (again, except where the finding specifically calls for action by directors). We believe it would be helpful to make clear that the board has the right to have access to findings including MRAs and MRIAs, and that this is separate from the issue of who has the obligation to act on such findings. Once given access to a supervisory finding, the board and/or an appropriate committee of the board can decide what if any action to take.

  Access to supervisory findings is necessary in order for the board to be able to exercise appropriate oversight over management; without such access, the board would not know with certainty the full landscape of supervisory issues for which it needs to hold management accountable.

  As drafted, the proposal could be read to conclude that the board would not have access to any supervisory finding that did not mention or impose an action item on the board. This may not have been the Federal Reserve's intention, and we request that this issue be clarified in any final guidance. As the Federal Reserve notes in the proposal, "The board would remain responsible for holding senior management accountable for remediating supervisory findings." Fulfilling such a responsibility, and more generally exercising appropriate oversight over management, would be difficult if the board did not have regular and convenient access to supervisory findings such as MRAs and MRIAs.

- *Question (6): What Federal Reserve supervisory expectations for boards are not included in Table A, yet interfere with a board's ability to focus on its core responsibilities and should be included in the proposal? Should such expectations be rescinded or revised? If revised, how?*

The Federal Reserve has requested comment on numerous pieces of specific guidance that have previously been issued. The list is extensive and spans multiple decades. We appreciate this effort to comprehensively cover the landscape. In addition to the specific guidance on the list, we also want to note two particular subject matter areas that cross over among multiple issuances (including some on the list in the proposal).

Cybersecurity

Cybersecurity is not mentioned specifically in the proposal, although it is covered explicitly or implicitly in some of the issuances cited in the proposal, including the Guidance on Managing Outsourcing Risk (SR 13–19/CA 13– 21). Cybersecurity is one of the issues that boards of directors have had to address in more and more detail in recent years — not only due to supervisory expectations, but due to risk management concerns as cyber threats continue to evolve. We believe cybersecurity is an important topic for the Federal Reserve to consider in crafting final guidance.

Cybersecurity is a highly technical subject that requires specific expertise to manage in a financial institution, including experience with technical aspects of information technology (IT). While it is unquestionably important for board members to understand such aspects in order to effectively oversee and evaluate the performance of personnel such as the institution's Chief Information Security Officer, it should not be necessary for each board member to possess expertise at the level of an IT professional in order to carry out such oversight duties. However, in recent years, the tone of communications from regulators about the need to robustly oversee cybersecurity issues has, at times, implied that individual directors must essentially serve as IT experts.

Again, to be clear, cybersecurity is undoubtedly one of the key risk areas facing financial institutions today. It absolutely is a subject within the province of the board in terms of exercising vigorous oversight over management's attention to cybersecurity matters. However, it would be helpful — and more realistic — for the Federal Reserve to clarify in the guidance, and in issuances it amends as part of this process, that the board's role in cybersecurity is centered on holding management accountable for performance in attention to cybersecurity matters, and reviewing institution-wide policies and outcomes from reviews such as those performed using the Federal Financial Institutions Examination Council (FFIEC)'s Cybersecurity Assessment Tool, rather than being directly involved in granular cybersecurity matters themselves.

Again, to be able to effectively hold management accountable, directors must be sufficiently educated on cybersecurity issues, and know what questions to ask — but that is not the same as serving directly as experts in cybersecurity matters. It would be helpful for the Federal Reserve to clearly state this.

Approval of Financial Institution's Policies and Procedures

Another broadly applicable topic is the board's expected involvement in reviewing and approving the financial institution's policies and procedures. It would be helpful for the Federal Reserve to clarify its supervisory expectations as to which policies and procedures — particularly procedures that operationalize the broader policies — that the board is expected to review and approve.

As a general matter, reviewing and approving institution-wide policies, particularly those involving enterprise-wide risk areas, is the province of the board (and, for certain types of policies, has been explicitly required by regulation or other regulatory issuance). However, there is currently confusion and uncertainty as to what regulators expect regarding the board's role in approving operational procedures that implement these broader policies. Especially as regulatory requirements and supervisory expectations have ramped up over the years, financial institutions have felt more and more pressure to err on the side of having the board, or a committee of the board, review and approve every policy and procedure of the institution — including the operational procedures that front-line employees use to carry out the broader policies. These procedures can number in the hundreds and run into the thousands of pages, as they involve detailed processes for performing various operational functions to comply with laws and regulations and execute the goals of the institution, as described in the overarching policies.

It would be helpful for the Federal Reserve to state explicitly which policies and procedures the board is expected to review and approve, and the source of authority for such expectations, such as a law or regulation, or a supervisory concern regarding safety and soundness, compliance, or risk management. The board should be aware of, and have the opportunity to review at any time, all policies and procedures; but it would be helpful, in particular, to make clear that, generally, the board is not required to officially review and approve all operational procedures, and instead may make its own decisions as to whether to do so or to leave this task in the hands of management.

Finally, in closing, we urge the Federal Reserve to continue on an interagency basis the important work begun by this proposal.

The Need for Interagency Coordination and Consistent Standards

We appreciate the common-sense changes to supervisory expectations that it seems the Federal Reserve is considering through this process. However, the approach should be extended consistently to boards of all financial institutions, not only bank holding companies and state member banks.

We recognize that the Federal Reserve can only act within its individual authority, and its supervisory guidance can bind only entities and persons under its jurisdiction. Thus, we urge the Federal Reserve to work with the other federal banking regulators to collaborate and coordinate efforts so that supervisory standards and expectations are consistent. This could be done through issuance of joint of guidance through the FFIEC, which would be the preferred route to ensure consistent standards across regulators.

Without such coordinated action, the seemingly inevitable result is differing standards for boards of directors at different types of financial institutions, with the variance depending on the institution's primary federal regulator. At IBC, we will feel this result acutely. Although IBC, as a bank holding company, is supervised by the Federal Reserve, our subsidiary banks have the FDIC as their primary federal regulator. This means that any relief given by this guidance would not extend to our banks' boards of directors.

Financial institutions, and the supervisory expectations of agencies, are best served when roles and responsibilities are clearly defined and resources are appropriately allocated. This should be the case consistently across types of financial institutions and across agencies' supervisory approaches.

Thank you very much for the opportunity to submit this comment letter. We appreciate the Federal Reserve's consideration of our comments, and welcome the opportunity to discuss any of them further.

Sincerely,

Dennis E. Nixon
Chairman and President
International Bancshares Corporation