

June 14, 2010

Secretariat
Basel Committee on Banking Supervision
Bank for International Settlements
CH-4002
Basel, Switzerland

Re: Consultative Document: *Principles for Enhancing Corporate Governance*

Ladies and Gentlemen:

The American Bankers Association¹ (ABA) welcomes the opportunity to comment on the consultative document (CP) published by the Basel Committee on Banking Supervision (Committee or BCBS), *Principles for Enhancing Corporate Governance*. We share the Committee's goals of promoting sound corporate governance practices for banking organizations, including appropriate board oversight of senior management, a robust risk management structure, and a transparent organizational structure. The ABA is broadly supportive of the CP. We appreciate the concept of proportionality that is present throughout the CP, consistent with other Committee publications, as well as the statement that the CP does not intend to establish a new regulatory framework layered on top of existing national legislation, regulation, or codes.

We have some recommendations for modification or enhancement of the CP in the following areas:

- The overview of bank corporate governance (paragraph 11 et seq.) states that, in addition to their responsibilities to shareholders, banks also have a responsibility to their depositors and to other recognized stakeholders, while recognizing that those responsibilities vary across jurisdictions. We would encourage domestic regulators to clarify those responsibilities and their supervisory expectations to the extent necessary in a given jurisdiction.
- In Principle 1 with respect to the board's overall responsibilities, it may be helpful to emphasize the on-going nature of the strategic planning process.
- Principle 1 appropriately emphasizes the need for an independent risk and control function. However, it is not until paragraph 75 of the CP that the important concept of collaboration between the risk and control function and operational lines of business is introduced. We believe that this important interaction could be discussed at an earlier point in the CP.

¹ The American Bankers Association represents banks of all sizes and charters and is the voice for the nation's \$13 trillion banking industry and its two million employees.

- Similarly, we would discuss at an earlier point in the CP the concept expressed in paragraph 89 that all employees responsible for risk-generating activities “own” the risk along with the risk and control function.
- Paragraph 30 under Principle 1 notes that a bank’s code of conduct should articulate acceptable and unacceptable behaviors. An important corollary is the need for banks to have an effective mechanism to detect the conduct of unacceptable behaviors or those that run counter to the bank’s risk appetite (the forward-looking view of acceptable risk that is discussed in the CP).
- Broadly, some of the principles may not be entirely appropriate for smaller banking organizations. Specifically, Principle 2 regarding board qualifications can be very difficult for smaller banks to operationalize fully. It may be difficult to ensure a sufficiently broad population of candidates, a sufficient number of qualified non-executive members, and the absence of board cross-memberships (see Paragraphs 37, 38, and 52). Smaller banks serve a more limited and local market than do larger banks. The directors of a smaller bank are more often drawn from the local business community, reflecting that local orientation and, thus, may not be as diverse as the boards of larger banks. The concept of proportionality is very important in operationalizing Principles 2 and 3.
- The ability of banks to ensure a sufficiently broad population of candidates, a sufficient number of qualified non-executive directors, and the absence of board cross-memberships can be impacted by the ability of shareholders in some jurisdictions to nominate and require a vote on their preferred board candidates (proxy access).
- Paragraph 45 under Principle 3 adopts a “comply-or-explain” approach to vesting the roles of the chairman and the chief executive in the same person. We believe that this is overly prescriptive as it presumes that the practice of vesting both responsibilities in a single person is not optimal risk management. We would posit that the appropriateness of this practice depends on the risk management structure and corporate culture of the individual bank and should not be viewed as a disadvantage.
- Paragraph 116 under Principle 12 (complex or opaque corporate structures) states that the bank should discuss with and/or report to, its supervisor regarding policies and procedures for the creation of new structures and the complexity of the group. We agree that the board should have an open dialogue with its supervisors about group structure but note that it ultimately is the board of directors that is responsible for decisions regarding corporate structure.

Responsibilities to Other Stakeholders. The overview of bank corporate governance (paragraph 11 et seq.) states that, in addition to their responsibilities to shareholders, banks also have a responsibility to their depositors and to other relevant stakeholders, while recognizing that those responsibilities vary across jurisdictions. Similarly, paragraph 22 under Principle 1 states that, in discharging its responsibilities, “the board should take into account the legitimate interests of shareholders, depositors, and other relevant stakeholders.”

The references to “other relevant stakeholders” are vague and could be interpreted in an overbroad manner. For publicly traded banks, the duties of care and loyalty are owed to their shareholders, the owners of the bank. The exercise of these duties should be consistent with the safe and sound operation of the bank and compliance with applicable laws and regulations, which, in turn, serve the depositors and other creditors of the bank. It is unclear whether this is the scope of responsibility intended by the CP or whether a broader scope is intended. We do not believe that a broader scope of responsibility is appropriate or necessary. At a minimum, domestic regulators should clarify the scope and nature of any responsibilities to depositors and other stakeholders as well as explain their supervisory expectations in this regard.

On-going Nature of Strategic Planning. Principle 1 provides that the board has overall responsibility for the bank, including approving and overseeing the implementation of the bank’s strategic objectives, risk strategy, corporate governance, and corporate values. We fully endorse this Principle. Our suggestion, however, would be to emphasize within the text underlying this Principle that strategic planning is not a point-in-time exercise but, rather, is an on-going and dynamic process that takes into account changes in markets, products, activities, the political environment, and technology.

Collaboration between Risk and Control Function and Operational Lines of Business. Principle 1 appropriately emphasizes the need for an independent risk and control function. However, it is not until paragraph 75 of the CP that the important concept of collaboration between the risk and control function and operational lines of business is introduced. We believe it is essential for the risk and control function to understand the operational lines of business for which it has responsibility in order to facilitate an effective and efficient interaction and communication. The risk and control function needs to understand the responsibilities of the business line, how it conducts its day-to-day operations to fulfill those responsibilities, and the internal controls in place in the business line to ensure it is operating in a safe and sound manner and in compliance with applicable laws and regulations. Having this understanding will facilitate a partnership and communication between risk and control and the business line that will allow the risk and control function to offer concrete and workable recommendations for improvement. Similarly, the business lines should have an understanding of the responsibilities of the risk and control function and its key objectives. Indeed, it may be appropriate for key risk and control personnel to take a “tour of duty” in an operating business line and for key business line personnel to have the experience of working in the risk and control function.

While a partnership model is ideal, we agree that it is imperative for the risk and control function to have a direct reporting line to the board and the ability to elevate any concerns it may have about a business line. By endorsing a partnership model, we in no way wish to imply that the risk and control function would be under the control of the business lines it oversees.

For smaller banks, it is important to recognize the role that the external auditor may play in providing a risk and control function. It may not be cost-effective or feasible for smaller institutions to have both a risk and control function and an external auditor. Internal audit may also play a risk and control function in these smaller organizations. We encourage flexibility in the interpretation of these principles to smaller banks.

Ownership of the Risk. The collaboration discussed above can play an important role in achieving the goal of paragraph 89 of the CP – that is, giving all employees responsible for risk-generating activities “ownership” of the risk. We would suggest a minor revision to the first sentence of this paragraph by adding to the end of the sentence “responsible for risk-generating activities.” This conveys the essential point without being unnecessarily overbroad.

Mechanism to Detect Unacceptable Behaviors. Paragraph 30 under Principle 1 notes that a bank’s code of conduct should articulate acceptable and unacceptable behaviors. An important corollary is the need for banks to have an effective mechanism to detect the conduct of unacceptable behaviors or those that run counter to the bank’s risk appetite (the forward-looking view of acceptable risk that is discussed in the CP). Again, a good understanding of the operations of key lines of business by the risk and control function could facilitate the development of appropriate and effective mechanisms to detect unacceptable behaviors.

Board Qualifications for Smaller Banks. We endorse fully Principle 2 as stated by the Committee. However, we note that the text supporting this Principle promotes standards that may be difficult for smaller banks to follow. We appreciate the concept of proportionality that is present in this and other Committee publications; however, it may be appropriate and helpful to provide some additional flexibility in the text around Principle 2 to recognize that smaller institutions may not have a broad population of board candidates or qualified non-executive members. Moreover, smaller institutions or those in smaller markets may not be able to avoid cross-memberships on boards of directors. Our members confirm the difficulty that smaller banks experience in attracting and retaining good directors, especially in smaller markets where the available “pool” of candidates can be limited. In smaller markets, the pool of directors generally consists of local professionals who may be reluctant to add to time commitments and work burdens; the concept of a professional non-executive director is not at all familiar to these banks. Moreover, as noted above, given the local focus of smaller banks, they may in fact find it most effective to have local businesspeople or customers on their boards.

Smaller banks or those in relatively small market areas may need to take special measures to obtain outside expertise to ensure that the bank has access to the wide range of talent needed to operate in the current environment. Banks that share directors with other financial institutions may need special policies, procedures, and internal controls to detect and prevent actual or potential conflicts of interest. We encourage the Committee to reflect the ability of banks to achieve the goals expressed regarding the qualifications and composition of the board in different ways.

We would suggest the following text for paragraphs 37, 38, and 52:

37. The bank should have an adequate number and appropriate composition of board members, in light of its size, complexity, structure, economic significance, and risk profile. Unless required otherwise by law, the board should identify and nominate candidates and ensure appropriate succession planning. To enhance board perspective and the ability of the board to exercise objective judgment, the bank should, to the extent possible and practicable, recruit members from a sufficiently broad population of candidates and include on the board qualified non-executive members who are capable of exercising sound objective judgment.

38. In identifying potential board members, the board should ensure that the candidates are qualified to serve as board members and are able to commit appropriate time and effort to fulfill their responsibilities. If

board members serve as directors or senior officers of companies that compete or do business with the bank, appropriate checks and balances and internal controls should be in place to avoid actual or potential conflicts of interest.

52. *The bank should establish committees that reflect the size, complexity, structure, economic significance, risk profile, and business activities of the bank. Committee membership should strive to mix skills and experience in order to understand issues fully, maximize objectivity, and bring fresh thinking to the relevant issues. To the extent possible and practicable, committees should include non-executive and/or independent directors. Non-executive and/or independent directors should have the opportunity to meet separately, both among themselves and with risk or control functions, in order to facilitate frank and timely dialogue.*

Dual Hatting Chairman and Chief Executive Roles. Paragraph 45 under Principle 3 adopts a “comply-or-explain” approach to vesting the roles of the chairman and the chief executive in the same person. We believe that the tone of this paragraph is overly prescriptive and presumes that the practice of vesting both responsibilities in a single person is not optimal risk management. In smaller banks and those in smaller market areas, it may not be practical or possible to separate these functions given the difficulty of securing top executive leadership. It may also not be practical or possible to have a lead or senior independent director at some banks.

We would posit that the appropriateness of the practice of dual hatting the chairman and chief executive depends on the risk management structure and corporate culture of the individual bank and should not be viewed as a disadvantage. There is no single correct method of structuring the leadership of a bank and dual hatting the roles of chairman and chief executive officer may be the best solution, or simply unavoidable, for a particular bank. Moreover, there are policies, procedures, and internal controls that can be put in place at banks to avoid excessive domination of the governance of the bank by the dual executive. Accordingly, we would suggest that paragraph 45 be worded in a more flexible manner that recognizes the practical difficulties of avoiding double hatting at smaller banks or those in smaller markets. We would suggest text along the lines of the following:

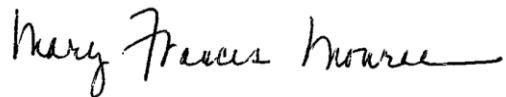
45. *An increasing number of banks, particularly larger, internationally active organizations, require the chair of the board to be a non-executive, except where otherwise required by law. Where such a separation is not feasible, and particularly where the roles of the chair of the board and the CEO are vested in the same person, the bank should have checks and balances and internal controls in place to avoid any inappropriate domination of the governance of the bank.*

Dialogue with Supervisors Regarding Corporate Structure. Paragraph 116 under Principle 12 (complex or opaque corporate structures) states that the bank should discuss with and/or report to, its supervisor regarding policies and procedures for the creation of new structures and the complexity of the group. We agree that the board should have an open dialogue with its supervisors about group structure but note that it ultimately is the board of directors that is responsible for decisions regarding corporate structure. Paragraph 116 appears to us to go too far in the direction of potentially substituting the judgment of supervisors for the judgment of the board and senior management of the bank, a substitution that is contrary to sound corporate governance. The responsibility for establishing and maintaining an appropriate corporate structure rests not with supervisors but with the board of directors and senior management of the bank. Accordingly, we would suggest the following substitute text for paragraph 116:

116. The bank should be prepared to explain to its supervisor the banking group's corporate structure and the purpose of key entities within the group, especially where the bank has a complex or opaque organizational structure.

We appreciate the opportunity to comment on the consultative document and are available to discuss our comments in greater detail. Please do not hesitate to contact the undersigned, or ABA Vice President and Senior Counsel, Carolyn Walsh, at 202-663-5253 (cwalsh@aba.com).

Respectfully submitted,

A handwritten signature in black ink that reads "Mary Frances Monroe". The signature is written in a cursive style with a long horizontal flourish at the end.

Mary Frances Monroe