

## Federal Reserve Guidance on Board of Directors' Effectiveness: Streamlining Board Duties and Promoting Diversity at the Board Level

by Rachel Brook

On February 26, 2021, the Board of Governors of the Federal Reserve System ("Federal Reserve") instituted important changes to its expectations surrounding board of directors' governance duties with the issuance of a Supervision and Regulation Letter setting forth Supervisory Guidance on Board of Directors' Effectiveness (the "Guidance"). [1] The Guidance details five characteristics of effective boards of large financial institutions [2] :

- (1) Set Clear, Aligned, and Consistent Direction Regarding the Firm's Strategy and Risk Appetite
- (2) Direct Senior Management Regarding the Board's Information Needs
- (3) Oversee and Hold Senior Management Accountable
- (4) Support the Independence and Stature of Independent Risk Management and Internal Audit
- (5) Maintain a Capable Board Composition and Governance Structure

The first four board attributes follow the trend—since the 2008 financial crisis—towards promoting the integration of an institution's risk considerations into its business strategy and increased board oversight of risk management and compliance efforts. However, the Guidance streamlines the board's responsibilities in this regard, and distinguishes the board's role from that of senior management. Specifically, the Guidance shifts certain responsibilities previously assigned to the board to senior management, placing boards in more of an oversight role to avoid confusion about the party responsible for day-to-day management. In differentiating the duties of the board from those of senior management, the Guidance emphasizes the need for increased accountability for senior management and the board's proactive engagement in information-sharing practices to stay informed on key matters.

But perhaps the most significant quality of an effective board rolled out by the Federal Reserve in the Guidance is the fifth one, which, in part, formalizes the expectation that board members will be selected from a diverse pool of candidates, including "women and minorities." The Federal Reserve emphasizes the criticality of having "a mix of skills, knowledge, experience, and perspectives" on an institution's board (and "a process designed to identify and select potential director nominees" that are diverse) to effectively manage the institution's business and risks. This expectation is in line with the well-established governance principal that the tone must be set from the top with respect to the institution's most important issues.

[1] Federal Reserve, SR Letter 21-3/CA 21-1: Supervisory Guidance on Board of Directors' Effectiveness (Feb. 26, 2021), available at <https://www.federalreserve.gov/supervisionreg/srletters/SR2103.htm>.

[2] The Guidance applies to "all domestic bank holding companies and savings and loan holding companies with total consolidated assets of \$100 billion or more," with the exception of U.S. intermediate holding companies of foreign banking organizations.

This past year has seen public outcry in the United States (and worldwide) for the long-overdue balancing of the scales with respect to the treatment of and opportunities for people from diverse backgrounds and the necessity of incorporating diverse viewpoints across the board, including in business. The Federal Reserve is addressing this important issue by making diversity of an institution's board directorship a compliance matter to be evaluated and enforced by regulators going forward. The specifics of how the Federal Reserve and other regulators will assess an institution's efforts to promote diversity, including on the board, remain to be seen. At a minimum, the board must consider a diverse group of candidates in the process for filling open director positions. With this guideline, the Federal Reserve is making clear that institutions must take diversity seriously and be proactive in fostering it at all levels of the organization.

In addition to rolling out the Guidance itself, the Federal Reserve has reviewed other active supervisory letters addressing the responsibilities of boards of directors and revised or retired them, as needed, to bring such precedent in line with the principles set forth in the Guidance. [3]

The Federal Reserve indicated that it intends to similarly revise the *Bank Holding Company Supervision Manual and Commercial Bank Examination Manual*. In the meantime, institutions should refer to the Guidance for best practices for boards of directors.

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### **About Walden Macht & Haran LLP**

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[3] See Federal Reserve, SR Letter 21-4/CA 21-2: Inactive or Revised SR Letters Related to the Federal Reserve's Supervisory Expectations for a Firm's Board of Directors (Feb. 26, 2021), available at <https://www.federalreserve.gov/supervisionreg/srletters/SR2104.htm>.