

November 2009

## DIRECTORS – ELIGIBILITY, QUALIFICATIONS, AND ROTATION

The Board expects the directors of the Federal Reserve Banks and their branches to be individuals who can contribute to the System's understanding of the economic conditions of their district and the effect of these conditions on the economy as a whole. Accordingly, directors should be familiar with the economic and business community of the territory for which they are selected. In addition, directors should be respected in their community and able to meet their financial obligations. Candidates should be selected who will represent the interests statutorily designated for their class. No member of Congress or of the Board's Federal Advisory Council or Thrift Institutions Advisory Council or the Consumer Advisory Council may simultaneously be a director of a Reserve Bank.

Directors will be selected without discrimination on the basis of race, creed, color, sex, or national origin. In light of the powers and responsibilities of the System's directors, the Board will only consider candidates for its appointments who are citizens of the United States, including naturalized citizens. The Board recommends that each Reserve Bank adopt a similar policy for Class A and Class B directors. The branch regulation requires that branch directors be United States citizens.

In nominating or selecting candidates for directors, each Reserve Bank and the Board should be mindful that a minimum of three directors on each Reserve Bank board will serve on the Reserve Bank's audit committee. Accordingly, each board must have at least three directors who are suited to fulfill the responsibilities of the audit committee.<sup>1</sup> These directors should be independent<sup>2</sup> and financially literate (i.e., able to understand financial statements and general financial concepts). At least one member should have banking, accounting, or other relevant financial proficiency.

#### Class A

By statute, Class A directors are nominated and elected by the member banks in each Federal Reserve district to represent the stockholding banks. There are few statutory or policy restrictions on eligibility for nomination to Class A beyond the general requirements discussed above. Class A directors may, for example, be officers or directors of a member or non-member commercial bank. If the nominee is an officer or director of a bank, he or she may serve as a Class A director only if nominated and elected by member banks in the same classification group as such person's

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<sup>1</sup> The qualifications for members of the audit committee are described in FRAM 1-007 (S-2622).

<sup>2</sup> Members of the audit committee are considered to be independent if they have no relationship with the Reserve Bank that might interfere with the exercise of their independence from management of the Bank.

bank (as discussed in FRAM 1-064, Procedure for Elections of Class A and Class B Directors). An officer or director of more than one bank is considered to be affiliated with the largest bank of these banks for purposes of this provision.

### Class B

Class B directors also are nominated and elected by the member banks in each Federal Reserve district. Class B directors represent the public and “shall be elected . . . with due but not exclusive consideration to the interests of agriculture, commerce, industry, services, labor, and consumers.”<sup>3</sup> By statute, no Class B director may be an officer, director or employee of any bank.

In order to give full effect to this requirement as well as the requirement that Class B directors be elected with consideration for sectors of the economy beyond banking, under the Board’s policy a Class B director may not be an officer, director (including advisory director) or employee<sup>4</sup> of a financial affiliation company. A financial affiliation company is any

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<sup>3</sup> See Federal Reserve Act § 4, 12 U.S.C. § 302.

<sup>4</sup> The term “employee” covers an individual who serves, at a minimum, as a common law employee of the relevant company. This would include any contractor for whom the employing entity should withhold federal income taxes. It would not include, however, an individual who works as a professional consultant and who has a bank or bank holding company, or an affiliate of such, as a client, unless the relationship is so close as to give rise to common law employee status.

bank,<sup>5</sup> bank holding company, branch or agency of a foreign bank, thrift institution, credit union, or subsidiary of any such company or entity. A financial affiliation company also includes any company that owns a bank or thrift institution, even if the company is not a registered bank holding company, if, at the time of election, the value of all banks and thrifts controlled by the company constitutes 15% or more of the assets, revenues, or net income of the consolidated holding company. A Class B director who is affiliated with a company that owns a bank or thrift institution (but that is not a financial affiliation company as defined above) should be selected because of the individual's connection with the nondepository activities of the company.

If a Class B director has an affiliation with a company that is not a financial affiliation company at the start of his or her service as a director of the Reserve Bank but that becomes a financial affiliation company during the Class B director's term, the Class B director must either resign from the impermissible affiliation or resign from the Reserve Bank's board within 60 days of the earlier of the date the director becomes aware of the impermissible affiliation or the date that the Board informs the Reserve

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<sup>5</sup> For purposes of this policy, a "bank" includes any entity eligible for membership in the Federal Reserve System, including a national bank, a savings bank, a Morris Plan bank, and an industrial loan company.

Bank that the company has become a financial affiliation company. During this 60-day period (or until the affiliation is severed, if sooner), the Class B director shall recuse himself or herself from all duties related to service as a Reserve Bank director. Although the Class B director has 60 days to resign from the impermissible affiliation or from the Reserve Bank board, the Class B director should advise the Reserve Bank of his or her intentions within 30 days of notification of the company's status as a financial affiliation company.

If a company becomes a financial affiliation company after the Class B director's election to a term that has not yet commenced, the Class B director may not begin service until he or she has resigned from the impermissible affiliation.

### Class C

By statute, Class C directors are appointed by the Board of Governors to represent the public, and, like Class B directors, are selected with "due but not exclusive consideration to the interests of agriculture, commerce, industry, services, labor and consumers." By statute, candidates for Class C directors must have been residents of their district for at least two years. Because the Board selects the chairman and deputy chairman of the board of directors from among the Class C directors, each Class C director should

have proven leadership credentials. The Federal Reserve Act provides that the chairman be a person of “tested banking experience.” Over the years, this requirement has come to be interpreted as requiring familiarity with banking or financial services.

### *Affiliations*

The eligibility limitations applicable to Class B directors also apply to Class C directors. Accordingly, no Class C director may be an officer, director, advisory director, or employee of a financial affiliation company.

If a Class C director has an affiliation with a company that is not a financial affiliation company at the start of his or her service as a director of the Reserve Bank but that becomes a financial affiliation company during the Class C director’s term, the Class C director must either resign from the impermissible affiliation or resign from the Reserve Bank’s board within 60 days of the earlier of the date the director becomes aware of the impermissible affiliation or the date that the Board informs the Reserve Bank that the company has become a financial affiliation company. During this 60-day period (or until the affiliation is severed, if sooner), the Class C director shall recuse himself or herself from all duties related to service as a Reserve Bank director. Although the Class C director has 60 days to resign from the impermissible affiliation or from the Reserve Bank board, the Class

C director should advise the Reserve Bank of his or her intentions within 30 days of notification of the company's status as a financial affiliation company.

If a company becomes a financial affiliation company after the Class C director's election to a term that has not yet commenced, the Class C director may not begin service until he or she has resigned from the impermissible affiliation.

### *Stockholdings*

By statute, no Class C director may be a stockholder of any bank. In addition, to give effect to this prohibition, it is the Board's policy that no Class C director may own stock in a bank holding company, foreign bank, subsidiary of a bank holding company, or operating subsidiary of a bank (collectively, together with banks, referred to as "financial stock issuers"). If a Class C director holds stock in a company that becomes a financial stock issuer during the course of the Class C director's term, the Class C director must divest the impermissible stock or resign from the Reserve Bank's board within 60 days of the earlier of the date the director becomes aware of the impermissible stockholding or the date that the Board informs the Reserve Bank of the company's status as a financial stock issuer. Until the time of complete divestiture or resignation, the Class C director shall recuse himself

or herself from all regular duties related to service as a Reserve Bank director. In addition, the Class C director may not purchase any additional stock in the relevant company until he or she resigns from the Reserve Bank's board.

Although the Class C director has 60 days to divest the impermissible stock or resign from the Reserve Bank board, the Class C director should advise the Reserve Bank of his or her intentions regarding divestiture or resignation within 30 days of notification of the company's status as a financial stock issuer.

Indirect interests in financial stock issuers. Class C directors are not disqualified by virtue of indirect ownership interests in financial stock issuers through limited types of widely held, diversified investment vehicles. In particular, Class C directors may hold interests in financial stock issuers through ownership of shares of a mutual fund so long as the mutual fund is registered under the Investment Company Act of 1940 and does not have a stated policy of concentrating in the financial services sector. Class C directors also may own shares of financial stock issuers through other diversified investment funds. For these purposes an "investment fund" means a mutual fund, common trust fund of a bank, pension or deferred compensation plan, or any other investment fund which is widely held (i.e.,

more than 100 participants) and where the director has no ability to exercise control over the fund's investment decisions. "Diversified" means that the fund holds no more than 5% of the value of its portfolio in the stock of any one financial stock issuer, and no more than 20% in the financial sector.

Class C directors may not hold other indirect interests in financial stock issuers, e.g., through a trust, limited partnership, or other investment vehicle, unless the Board has determined that the interests are not so direct or substantial as to be disqualifying. In making this determination, the Board will consider various relevant factors including: (1) the nature of the director's ownership interest in the financial stock issuer (e.g., as grantor, trustee, beneficiary, or partner); (2) the director's role, if any, in the fund's investment decisions; (3) the size of the director's proportional interest in the financial stock issuer; and (4) the fund's investment strategy and the composition of its assets.

A candidate for Class C directorship must divest prohibited interests (including interests in companies that become financial stock issuers after the director's appointment to a term that has not yet commenced) before taking office. Divestiture should normally be accomplished by sale or transfer of the stock to a person other than the director's spouse or minor child. If after taking office a Class C director acquires a prohibited interest

by inheritance or other method not initiated by the director, that interest must be divested within 60 days.<sup>6</sup>

Ownership of stock by a spouse or minor child that would be impermissible if owned by a Class C director, though not expressly attributed to the director or prohibited by the Federal Reserve Act, is one of many factors the Board weighs in assessing an individual's eligibility for Class C. In addressing this factor, the Board will consider the number of shares and percentage owned, the method of acquisition, the period of time the shares have been held, the prominence and location of the financial stock issuer, and any other factors that bear on the likelihood of public association of the director or director candidate with the financial stock issuer. In addition, the nature and extent of a candidate's involvement with such an investment (e.g., through management or investment advice), may affect an individual's eligibility for service. Finally, a Class C director should not encourage or participate in the purchase of stock by or for his or her spouse or minor child if ownership of that stock would be impermissible for the director.

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<sup>6</sup> As noted above, a Class C director may not deliberately acquire prohibited interests after taking office.

A director whose spouse or minor child owns shares of a bank or bank holding company may be prohibited by federal statute from acting on certain matters affecting the bank or bank holding company, so he or she should seek guidance from the Reserve Bank's general counsel before participating in such matters.<sup>7</sup>

### Branch Directors

Branch directors appointed by the Board must satisfy the same eligibility requirements that pertain to Class C directors, except that the Board may appoint a shareholder or advisory director of a commercial bank or other financial affiliation company to serve as a branch director. The Board may, in extenuating circumstances and at the request of a Reserve Bank, waive this restriction and appoint one director of a commercial bank as a branch director. Branch directors appointed by Reserve Banks may satisfy the eligibility requirements of either Class A or Class B directors. Accordingly, directors of commercial banks are eligible to serve as Reserve Bank-appointed branch directors. No director of a Federal Reserve Bank may serve simultaneously as a branch director.

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<sup>7</sup> Certain provisions of the Federal ethics laws apply to directors of Federal Reserve Banks and branches as well as to Board and Reserve Bank employees. In general, these provisions prohibit a covered person from participating in any particular matter in which the person or certain persons related by family or business have a financial interest. 18 U.S.C. 208.

## Rotation Policy

**Head-office directors.** In appointing Class C directors of Federal Reserve Banks, the Board has a policy of rotation, under which the service of an individual as a director has been limited to two full terms. The Board believes that the advantages of rotation among Federal Reserve Bank directors outweigh any disadvantages and that any steps that banks might take toward making the rotation principle more generally applicable in the election of Class A and Class B directors should be encouraged as far as possible. In accordance with this policy, Class C directors will not be reappointed if they have served two full terms of three years each, or if, by the end of the new term, the individual would have served as a director (including all service as a Class A, B, or C director) for more than seven years of continuous service. The Board has the authority to grant exceptions where appropriate, but would expect to do so only in limited circumstances.

The chairman and deputy chairman of each Reserve Bank are designated annually by the Board of Governors for terms running from January 1 through December 31. Normally, a Class C director designated as chairman may serve in that capacity for a total of up to three years.

**Branch directors.** The Board will follow a similar rotation policy with Board-appointed branch directors and will generally limit such service

to a maximum of seven years of continuous service at the branch. It should be noted, however, that service as a branch director does not count as service at a head office and branch directors may be appointed to directorships at head offices without regard to their tenure as branch directors. The Board encourages the Reserve Banks to apply a similar rotation policy for branch directors appointed by the Banks.

### Waivers

In rare and exigent circumstances, the Board may approve a request from a Reserve Bank for a waiver to this policy to permit a director, director-elect, or candidate to continue to be eligible to serve as a director. The Reserve Bank may submit a written request to the Board describing the need for the waiver upon a vote of the board of directors on whether to recommend a waiver from the Board. The Board must approve the Reserve Bank's waiver request in order for it to become effective.