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Federal Reserve Requirements for Bank Holding Company Boards of Directors and Audit Committees

By Leanne Kelly

The Reserve Bank of Minneapolis often receives questions regarding Federal Reserve requirements for boards of directors and audit committees at bank holding companies – from the minimum number of board members to independence requirements for the board and audit committee. There are no Federal Reserve statutory requirements for boards and audit committees except at companies with total assets of $500 million or more and at public companies. However, as discussed in this article, there are numerous aspects to consider when filling the bank holding company's board and audit committee positions.

Board members are fiduciaries who help ensure the success of the organization. The board makes the decisions regarding strategic direction and risk appetite and it sets the standards for sound ethical and legal governance. The most direct ways of managing and controlling risk and ensuring the success of the organization are through the board's overall business strategies and significant policies and employment of senior management capable of implementing the institution's business plans within the board's risk tolerances and in compliance with laws and other supervisory requirements. Given the board's overarching responsibilities, board members need to be knowledgeable about the organization's activities and risk management practices and to be independent of management in order to effectively oversee management and avoid conflicts of interest. Likewise, the audit committee requires the appropriate level of knowledge and independence to ensure the integrity of the financial reporting and the adequacy of the control structure.

State and federal banking statutes set the minimum number of board members at the depository institution level; however, the Federal Reserve has not set a minimum number of directors for bank holding companies. An organization's bylaws will typically authorize the number of directors and officers. Bank holding companies can have as few as one director and up to 15 or more, with additional advisory board members and a variety of committees. The number of members and composition of a bank holding company's board and its committees depends on the size and complexity of the organization's activities and how the lower-tier companies are organized.

Section 36 of the Federal Deposit Insurance Act, as implemented by part 363 of the FDIC's regulations (12 C.F.R. 363), specifies that FDIC-insured depository institutions with total assets of $500 million or more must have annual independent audits, management reports, and board-level audit committees. There are specific requirements for audit committees over certain asset thresholds and under certain circumstances. As noted below, the depository institution's audit committee requirements may be satisfied at the bank holding company if certain conditions are met.

The audit committee must consist of independent directors as noted. For institutions with total assets between $500 million and $1 billion, all audit committee members must be outside directors and the majority must be independent of management. However, for institutions with total assets of $1 billion or more, all audit committee members must be outside directors and independent of management. One caveat is that every public company is required under Section 301 of the Sarbanes-Oxley Act to have an audit committee composed entirely of independent directors (see 15 U.S.C. 78j-1).

Additionally, for insured depository institutions with more than $3 billion in total assets, Section 36 requires the audit committee to: 1) include members with banking or related financial management expertise, 2) have access to its own outside counsel, and 3) not include any large customers of the institution, regardless of whether the audit committee is at the holding company or the subsidiary institution.

Section 36 also provides that the audit committee for a top-tier or mid-tier holding company can satisfy the requirements for the depository institution if three requirements are met. First, the consolidated total assets of the insured depository institution(s) represent 75 percent or more of the consolidated total assets of the holding company. Second, the holding company provides services and functions comparable to the insured depository institution. Third, the insured depository subsidiary (a) has less than $5 billion in total assets or (b) has a CAMELS composite rating of "1" or "2" when its total assets are $5 billion or more. Otherwise, the individual institution must maintain its own audit committee.

We encourage firms to contact Safety and Soundness staff at your local Federal Reserve Bank for more information.

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Fed Notes is provided through a partnership the Bank Holding Company Association shares with the Federal Reserve Bank of Minneapolis.