

January 29, 2024

NYDFS Adopts Final Guidance on Assessment of Character and Fitness of Directors, Senior Officers and Managers

Introduction

On January 22, 2024, the New York State Department of Financial Services (“NYDFS”) issued final Guidance (the “Guidance”) for most institutions holding a license from the NYDFS¹ (“Covered Institutions”) setting out NYDFS’s expectation that Covered Institutions engage in rigorous character and fitness assessments of directors, senior officers and managers, both at onboarding and on an ongoing basis.² The Guidance reflects an ongoing effort by policymakers and regulators to raise corporate governance and oversight standards following the bank failures of 2023, including NYDFS’s closure of Signature Bank in March 2023.

The Guidance states that NYDFS expects Covered Institutions to update their vetting frameworks for directors, senior officers and managers to require ongoing vetting and to define warning signs or indicators that warrant additional scrutiny, such as prior service at institutions that have been subject to regulatory actions or proceedings. The Guidance is substantially similar to NYDFS’s proposed guidance issued on June 30, 2023, but clarifies the non-binding legal nature of the Guidance in response to public comments highlighting that issue.³

Key Features of the Guidance

Covered Institutions

The Guidance applies to the following Covered Institutions:

- (a) New York state-regulated banking organizations (i.e., banks, trust companies, private bankers, savings banks, safe deposit companies, savings and loan associations, credit unions, investment companies, and branches, agencies and representative offices of foreign banking organizations licensed by NYDFS);

¹ “Covered Institutions” are defined in the Guidance and discussed more below in Part II.a.

² N.Y. Dep’t of Fin. Servs., *Industry Letter: Guidance on Assessment of the Character and Fitness of Directors, Senior Officers, and Managers* (2024), https://www.dfs.ny.gov/industry_guidance/industry_letters/il20240122_guidance_on_assessment (the “Guidance”).

³ N.Y. Dep’t of Fin. Servs., *Proposed Guidance on Assessment of the Character and Fitness of Directors, Senior Officers and Managers* (2023), https://www.dfs.ny.gov/industry_guidance/industry_letters/il20230509_guidance_assessment_fitness.

- (b) Non-depository financial institutions licensed or chartered under the New York Banking Law except for mortgage loan originators;⁴ and
- (c) Institutions licensed under Part 200 of the Regulations of the Superintendent of Financial Services (i.e., virtual currency institutions).⁵

Designated Persons

The Guidance is applicable to each member of the board of directors, board of trustees, and/or board of managers, or similar body as applicable and each senior officer (each, a “Designated Person”). While the Guidance does list some positions that are presumed to be “senior officers,” the definition of a senior officer may extend beyond such titles or positions and “refers to every officer who participates or has authority to participate (other than in the capacity of a director) in major policy-making functions of a Covered Institution.” The Guidance clarifies that an individual holding any one of several specified titles⁶ at a Covered Institution is considered a senior officer, unless, “by resolution of the board of directors or by the bylaws of the Covered Institution, such individual is excluded from participation in major policy-making functions and that individual in fact does not participate therein.” The definition of a senior officer is similar to definitions utilized by the federal banking agencies in their reviews of changes in senior executive officers.⁷

Policies and Procedures for Character and Fitness Assessments

NYDFS states that the assessment of the character and fitness of Designated Persons is important in protecting the safety and soundness of a Covered Institution because “a compromised director, officer, or manager can threaten an organization’s safety and soundness at any time during that individual’s service.”⁸ Covered Institutions are expected to develop, implement and maintain policies and procedures for vetting character and fitness of the Designated Persons in the onboarding process and on an ongoing basis. The vetting process should include consistent, ongoing methods to ensure that no intervening circumstance—such as a conflict of interest or a material change—would make the Designated Person unfit for their role. Covered Institutions should also respond promptly to intervening circumstances that would make a Designated Person’s continuation in their role improper. If material adverse findings regarding a Designated Person result in the person’s removal or transfer or to modifications to their current functions, the institution is expected to promptly notify the NYDFS.

Vetting policies and procedures should define the sensitive issues, warning signs and other indicators that would warrant extra scrutiny, such as service at a prior institution subject to a regulatory action such as an enforcement action, receivership or conservatorship. Although the Guidance does not dictate any specific frequency or type of assessment, the Guidance advises that each Covered Institution’s framework should be “consistent with the risk profile of [its] operations,”⁹ and provides an Appendix¹⁰ with questions that are drawn from best practices that Covered Institutions may consider utilizing in developing their own vetting frameworks.

⁴ NYDFS stated that the Guidance does not apply to mortgage originators because “the substantive concerns reflected in this Guidance are already addressed through the licensing and renewal process [of Mortgage loan originators] and there are no other Designated Persons for which a regular vetting and assessment process would be required.”

⁵ See 23 NYCRR § 200.

⁶ The specified titles include “[a]ny chief executive officer, chief financial officer, chief operations officer, chief compliance officer, chief legal officer, chief risk officer, president, senior executive vice president, executive vice president, secretary of the board of directors, or treasurer.”

⁷ See, e.g., 12 C.F.R. § 5.51(c)(4).

⁸ See Guidance ¶ 1.

⁹ See Guidance ¶ 10.

¹⁰ See Guidance Appendix: Suggested Questions to Facilitate Initial and Ongoing Assessment of Designated Persons’ Character and Fitness. Available at: https://www.dfs.ny.gov/industry_guidance/industry_letters/il20240122_guidance_on_assessment. We have also reprinted the Appendix as an appendix to this update.

Covered Institutions are expected to review the materials that they generate in the character and fitness vetting process and relay the findings to their board of directors (or equivalent) and chief compliance officer (or equivalent). Covered Institutions are also expected to maintain a copy of their vetting policy for NYDFS examiners to review to confirm that the Covered Institution is in compliance with the Guidance.

Conclusion

While most Covered Institutions will already have some policies or procedures in place to evaluate the fitness of their directors and executive officers, at many Covered Institutions, current policies and procedures may focus on the initial onboarding of key personnel or apply to a smaller universe of individuals. Thus, the Guidance’s recommendation that Covered Institutions conduct ongoing assessments of personnel defined as senior officers may require review and revision of existing practices in this area. The Guidance also makes clear that it should not be viewed as limiting the scope of any other law or regulation. For instance, in what may be an unlikely hypothetical, if there were a conflict between the Guidance and a privacy law (e.g., the Gramm-Leach-Bliley Act or the Health Insurance Portability and Accountability Act), the privacy law would take precedence. The issuance of the Guidance suggests that, going forward, NYDFS examiners will be more carefully scrutinizing character and fitness policies and procedures and their ability to guard against “compromised” directors and officers, as well as ordinary conflicts of interest.

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Appendix from NYDFS Guidance on Assessment of Character and Fitness of Directors, Senior Officers and Managers

Suggested Questions to Facilitate Initial and Ongoing Assessment of Designated Persons' Character and Fitness

1. Acknowledge that you have reviewed and understand the following policies of [Covered Institution] and provide in a separate attachment evidence of any documented exceptions to compliance with these policies:
 - Gifts and Loan Policy
 - Insider Trading Policy
 - Electronics Communications Policy
 - Social Media Policy
 - Data Protection Policy
 - Records Management Policy
 - Conflict of Interest Policy
 - Health and Safety Policies
 - Corporate Opportunity Policy
 - Harassment and Discrimination Policies
 - Outside Business Policy
 - Political Contributions Policy
 - Personal Trading Policy
 - Outside Lobbying Activity Policy
 - [Other applicable policies]
2. For ongoing assessment, to the best of your knowledge, have you been in compliance with all above-listed policies [during [year(s)]], and made all disclosures required, including seeking exceptions from these policies as appropriate, and being granted such exceptions?
3. During [year(s)], have you been charged with, indicted for, or convicted of a crime, and/or pleaded *nolo contendere* in any criminal matter (including, but not limited to, driving under the influence, reckless driving and/or disorderly conduct)?
4. Have you or any financial institution with which you are, or were, associated with, been sanctioned and/or censured in any way by a banking or securities regulator during [year(s)], including any regulatory sanction, consent order, enforcement order, supervisory agreement, civil monetary penalty or other administrative penalties?

5. Have you been the subject of any professional disciplinary actions, denied a license, and/or had a license suspended or revoked during [year(s)] (e.g., a governmental or professional licensing organization), excepting banking and securities regulators referenced in Question 4?
6. Please describe in a separate attachment, any civil litigation, investigation or sanction—including but not limited to any regulatory sanction, consent order/agreement, enforcement order/agreement, or other administrative findings or penalties—in which you have, to your knowledge, been named or have otherwise become involved in your professional capacity, or which have been initiated against a prior employer in connection with your responsibilities in that position, in the preceding ten (10) years.
7. Have you ever been dismissed or asked to resign from past employment, including a less than honorable discharge from military service?
8. Have you been involved in any of the following filings where the filing was denied, disapproved, withdrawn or otherwise returned without favorable action by a federal or state regulatory authority or a self-regulatory organization?
 - A charter or license application, a depository institution holding company application or an application for federal deposit insurance, in which you were listed as an organizer, director, senior executive officer, or a person that would own or control (either individually or as a member of a group) 10 percent or more of any class of voting securities or other voting equity interest of the institution, or similar position
 - A merger application in which you were listed as a director, senior executive officer or similar position
 - A notice of change in director or senior executive officer, or similar form, in which you were listed as a director, senior executive officer or similar position
 - A notice of change in control for a depository institution or other company, or a similar form, in which you were listed (either individually or as a member of a group) as an acquirer or transferee
 - Any other application, notice or other regulatory or administrative request which was filed with a federal or state regulatory authority or a self-regulatory organization in which you were listed in some capacity
9. Has anyone in your immediate family or an individual living in your household worked for the Covered Institution or an affiliate in [year(s)]? If so, please state their name and their relationship to you. “Immediate family” means the individual’s children, parents, siblings, spouse or partner.
10. Have you or an immediate family member started or continued an outside business relationship with an auditor of [Covered Institution] during [year(s)]?
11. Please describe in a separate attachment all indebtedness to [Covered Institution] or an affiliate that you have incurred [during the past year / since your previous report] (excluding indebtedness associated with a general-purpose credit card), and the balance outstanding of all such indebtedness to [Covered Institution] or an affiliate at the end of [year].
12. Please describe in a separate attachment any lobbying activities in which you have been engaged in your personal capacity during [year(s)] and whether you were registered as a lobbyist in any jurisdiction during [year(s)].
13. Please describe in a separate attachment any litigation (unless described above) or bankruptcy proceedings of which you have been a part during [year(s)] and provide copies of all relevant documents.

14. Do you owe outstanding child support in connection with any unemancipated child(ren)?
15. Please describe in a separate attachment all settlements of litigation (threatened or actual) brought against you in your personal or a professional capacity during [year(s)] and provide copies of all relevant documents.
16. Have you or any company with which you are associated or were associated with during [year(s)]:
 - Filed a petition under any chapter of the Bankruptcy Code or had an involuntary bankruptcy petition filed against you or the company?
 - Defaulted on a loan or financial obligation of any sort, whether as obligor, cosigner or guarantor?
 - Forfeited property in full or partial satisfaction of any financial obligation?
 - Had any liens or other judgments filed against you?
 - Had wages or income garnished for any reason?
 - Failed or refused to pay any outstanding judgments?
17. Have you filed/paid all of your required income and other taxes for [year(s)]?
18. Please list in a separate attachment all companies (whether publicly traded or not) and any organizations (including not-for-profit and/or charitable) of which you have been a member of the board of directors or an executive officer during [year(s)].
19. Have you been a senior officer or a board member at a financial institution that filed for reorganization or bankruptcy; became subject to a receivership or conservatorship proceeding; became subject to a resolution or liquidation proceeding; had its license, charter, or registration surrendered or revoked; received financial assistance from a federal or state agency or instrumentality (e.g., FDIC); merged with or been acquired by an institution that received financial assistance from a federal or state agency of instrumentality in connection with the transaction; or otherwise failed or ended business operations?
20. Please disclose all compensation received during [year(s)], beyond amounts paid to you as compensation by [Covered Institution].

This memorandum is not intended to provide legal advice, and no legal or business decision should be based on its content. Questions concerning issues addressed in this memorandum should be directed to:

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