



*Task Force on  
Bank Director Mitigation of Personal Liability and Reputational Risks  
Looming Issues Subcommittee:*

## **THE NEW CORPORATION & IMPACTS ON FIDUCIARY DUTIES**

*Subcommittee:*  
John M. Geiringer  
Paul Harris  
Thomas P. Vartanian, Reporter

December 2021

## **INTRODUCTION: EVOLVING CORPORATE TRENDS**

History demonstrates that the structure, nature, and goals of corporations change from time to time. It happened in the early 20<sup>th</sup> century, the 1960s, and is happening again in the 2020s.

Milton Friedman framed the issue in 1970 in his [landmark article](#) declaring profit to be the principal goal of the corporation.

Regulators reframed the issue when they began to assert that directors and officers of FDIC-insured banks owed a fiduciary duty to the FDIC as receiver, presumably under the Trust Fund Doctrine of corporate law. That doctrine holds that when a company is within the zone of insolvency, fiduciary duties shift to creditors of the institution as the real parties in interest. Case law in support of the FDIC's position has never been clearly established, but that is less important in a context where many cases are settled before trial.

In 2019, the Business Roundtable issued a [statement](#) redefining the purpose of corporations to promote an economy that serves all Americans.. This is a trend that is sweeping through Europe.

JPMorgan's Board of Directors recently [rejected](#) an effort to designate the company as a "public benefit corporation" under Delaware law. The Board cited a legal review it commissioned stating, among other things, that when the interests of stockholders and other constituencies conflict at a corporation like JPMorgan, "the board's fiduciary duties require it to act in a manner that furthers the interests of the stockholders.". But this trend is not likely to recede entirely.

## **THE IMPACT ON FIDUCIARY DUTIES**

This trend raises new issues and potential new director obligations that are likely to be increasingly important in the future, of which directors and their counsel should be aware:

- How do developing concepts like ESG (Environmental, Social and Corporate Governance) and new technological opportunities, such as artificial intelligence, quantum computing and corporate investing in cryptocurrencies, impact the definition of fiduciary duties, and to whom are they owed?
- How might bank regulators use these developments (particularly in a crisis atmosphere) in enforcement and civil suit proceedings to assert that the Board's policies or inattention to changing trends damaged the institution?

This Subcommittee has considered these questions and provides the following reference material for members of the American Association of Bank Directors to consider with their counsel to guide their actions and inform their defenses.<sup>1</sup>

## **1. RESPONSIBILITIES OF THE CORPORATION TO “STAKEHOLDERS”**

**The New Concept:** A legal analysis considering recent developments references “a new round of politically driven and potentially misdirected governmental intervention,” noting legislative efforts (*e.g.*, the Accountable Capitalism Act introduced by Senator Elizabeth Warren in August 2018) to (i) extend the legal constituents that a board of directors must protect; and (ii) impose social goals on the company. This new paradigm is premised on the idea that stakeholder governance and ESG (environmental, social, and governance) are indeed in the best interests of shareholders and are consistent with the fiduciary duties of boards of directors to their corporations and shareholders.

**Potential Impact for Directors:** Bank directors are subject to extensive and prescriptive regulatory expectations and guidance (see, for example, the Office of the Comptroller of the Currency’s November 2020 Directors Book: Role of Directors for National Banks and Federal Savings Associations). The expectations and guidance are often linked to “safety and soundness.”

As the “New Paradigm” continues to evolve, bank directors will need to consider implications specific to their role, including their ability to focus on long-term and strategic matters (versus short-termism), given extensive and prescriptive regulatory expectations for bank directors that have a real-world impact on matters that bank boards review and discuss at board meetings. It is also conceivable that regulators, in viewing themselves as “stakeholders,” will invoke the New Paradigm to reinforce responsibilities that bank boards owe them.

**Reference Material:** Posts at the Harvard Law School Forum on Corporate Governance ([corpgov.law.harvard.edu](http://corpgov.law.harvard.edu)) by Martin Lipton of Wachtell, Lipton, Rosen & Katz, including a January 11, 2017, post entitled “Corporate Governance: The New Paradigm” and a February 11, 2019, post entitled “It’s Time to Adopt the New Paradigm.”

---

<sup>1</sup> The issues discussed in this document must be evaluated in the context of actual facts and circumstances. This document is not intended to provide legal advice of any kind. Everyone, including directors, should consult their own counsel and not rely on the statements or assertions contained herein.

## 2. ALLOCATION OF RISK OVERSIGHT

**The New Concept:** The Federal Reserve has stated that “[a]ppropriate oversight by the board of directors of the risks undertaken by complex banking organizations requires significant knowledge, experience, and time. Therefore, it is important for a bank holding company with total consolidated assets of \$50 billion or more to have a separate committee of its board of directors devoted to risk-management oversight.” The “other board committees, such as audit or finance, may have some involvement in establishing a banking organization’s risk management framework. *However, a stand-alone committee, rather than a joint risk/audit or risk/finance committee, enables appropriate board-level attention to risk management*” [Emphasis Added].

**Potential Impact for Directors:** This rule imposes a limitation on a bank holding company (BHC) board’s ability to allocate risk oversight to its committees in a way that the BHC deems to be appropriate for the organization. For example, many BHCs recently have established technology committees and may determine, based on the experience of its directors who serve on those committees, that the technology committee is best suited to oversee technology-related risks. Similarly, a BHC may reasonably determine that the audit committee is best suited to oversee operational risk. This flexibility is particularly important, given that the risk environment is dynamic and that risk committees have substantial oversight responsibilities.

Subject boards will need to consider whether to discuss this requirement with their regulators. Failure to comply with the requirement may result in an enforcement action, although whether that consequence follows may depend on a particular institution’s examiners and how strict they are in construing and enforcing the rule. It is also possible that an examiner for smaller banks may expect the stand-alone risk oversight structure, whether as a “best practice” or otherwise.

**Reference Material:** The Federal Reserve System’s Enhanced Prudential Standards (EPS) for Bank Holding Companies (12 C.F.R. Part 252 – March 27, 2014) requires BHCs with total consolidated assets of \$50 billion or more to establish a stand-alone risk committee.

Section 165(h) of the Dodd-Frank Wall Street Reform and Consumer Protection Act requires a separate risk committee composed of independent directors for publicly traded bank holding companies and financial holding companies regulated by the Federal Reserve. Enhanced prudential supervision does not preclude other committees from being involved in risk oversight.

### 3. CRYPTOCURRENCIES<sup>2</sup>

**The New Concept:** Whether they are the next step in the development of money and commerce or the most recent iteration of the tulip bulb scandal of the 17<sup>th</sup> century, the value of approximately 7,500 cryptocurrencies today exceeds \$1 trillion dollars, with legitimate Fortune 100 companies investing in them instead of Treasury notes. That raises a host of issues for traditional financial markets and for directors of financial companies, as the attractiveness of cryptocurrencies and other crypto assets expands as they are used in an increasing list of funds, futures, derivatives, and other developing capital market products.

**Potential Impact for Directors:** If the cryptocurrency market collapses at some point, given the absence of intrinsic value or government backing, regulators likely will not hesitate to assert theories against directors who allowed their institutions to participate in their creation, storage, financing, and transmission. Similarly, if crypto becomes the next big important element of financial services, regulators may question how institutions failed to handle the opportunities.

**Reference Materials:** In a series of interpretive letters, the Office of the Comptroller of the Currency (OCC) detailed what cryptocurrency products and services banks can offer. In particular, the OCC opined that banks may custody customers' digital assets ([Interpretive Letter #1170](#)), hold the reserves of stablecoin issuers ([Interpretive Letter #1172](#)), and use independent node verification networks and stablecoins to perform bank permissible functions, such as payment activities ([Interpretive Letter #1174](#)). The OCC warned that banks should be cognizant of the risks posed by cryptocurrency offerings, including risks related to money laundering and cybersecurity.

The OCC subsequently issued guidance ([Interpretive Letter #1179](#)) that requires national banks and federal savings associations to demonstrate that they have established adequate controls before they can engage in certain cryptocurrency, distributed ledger, and stablecoin activities. All of this OCC guidance can be applicable to state-chartered banks headquartered in states with national bank parity provisions.

The Treasury Department's Financial Crimes Enforcement Network (FinCEN) has issued [extensive guidance](#) concerning convertible virtual currencies (CVCs), including the following advisory designed to assist financial institutions in identifying and reporting suspicious activity concerning how criminals exploit CVCs.

The Office of Foreign Assets Control (OFAC) has [confirmed](#) that U.S. persons' obligations are the same, regardless of whether transactions are denominated in traditional fiat currency or cryptocurrency and has included certain digital wallet addresses on its SDN list.

---

<sup>2</sup> Thanks to Justin Steffen for his contribution.

The U.S. Securities and Exchange Commission (SEC) has [clarified](#) that cryptocurrencies can constitute securities, thus requiring issuers to comply with registration requirements, and potentially subjecting other industry participants to securities law violations.

Regarding operational and reputational risks, including theft, hacking, and cybersecurity, cryptocurrency wallets and exchanges are subject to cyberattacks, requiring due diligence and other safeguards. ([New Secure Approval to Backup Cryptocurrency Wallets](#), University of Central Florida; [Cryptocurrency Hardware Wallets Can Get Hacked Too](#), WIRED)

[As noted by the Department of Justice](#), criminals are increasing using cryptocurrencies to launder money. To combat cybercrime, many, including the U.S. government, have turned to digital forensics firms that specialize in tracing and tracking cryptocurrencies. ([U.S. Law Enforcers Partner with Cryptocurrency Tracking Firm to Fight Financial Crime](#), Thomson Reuters; [Profile of CipherTrace, Inc.](#) on USASpending.gov)

Although insurance products exist, [insurers have been reluctant](#) to insure cryptocurrency products and services, leaving cryptocurrency businesses (and their customers) at risk.

Digital wallet providers [have received customer complaints](#) stemming from their inability to move, withdraw, or access their cryptocurrency holdings.

Cryptocurrency prices are volatile. Government agencies have [attempted to educate](#) consumers about this (and other related) risks.

#### **4. ENVIRONMENTAL, SOCIAL & GOVERNANCE**

**The New Concept:** The roles and responsibilities of corporations are being challenged and reevaluated by advocates of making corporations answerable to a larger number of constituents (*e.g.*, employees, customers, and the community), and responsible through their lending and disclosure standards for issues like environmental climate change. Similarly, advocates, such as legislators at the federal and state levels, are arguing that corporations owe duties to this larger group of constituents that go far beyond what has traditionally been held to be their duty to protect the economic interests of the shareholders. Where the fight over definitions ends and the establishment of new obligations begins is still a work in progress.

**Potential Impact for Directors:** If this trend takes a legal and regulatory hold, regulators likely will begin to assert theories against directors who did not permit their banks to engage in these new operating principles.

**Reference Material:** Organizational transparency and responsibility demonstrated by standards for sustainability reporting – the [GRI standards](#).

A group of Central Banks and supervisors willing, on a voluntary basis, to share best practices and contribute to the development of environment and climate risk management in the financial sector, and to mobilize mainstream finance to support the transition toward a sustainable economy. See [Network of Central Banks and Supervisors for Greening the Financial System](#) (NGFS).

An independent standards board that is accountable for the due process, outcomes, and ratification of [Sustainability Accounting Standards Board](#) (SASB) *principles*.

Established by the Financial Stability Board, the [Task Force on Climate Related Disclosures](#) (TCFD) develops recommendations for more effective climate-related disclosures that could promote more informed investment, credit, and insurance underwriting decisions and, in turn, enable stakeholders to understand better the concentrations of carbon-related assets in the financial sector, and the financial system's exposures to climate-related risk.

The Federal Reserve Board has issued several papers on the subject. See Federal Reserve, [Climate Change and Financial Stability](#) (March 2021) and Federal Reserve Bank of New York, [How Bad Are Weather Disasters for Banks?](#) (November 2021)

[Section 342 of the Dodd-Frank Act](#) (2010) requires each banking agency to establish an Office of Minority and Women Inclusion (OWMI) to report annually to Congress on the voluntary diversity self-assessment data received from their respective regulated institutions.

The [Interagency Policy Statement Establishing Joint Standards for Assessing the Diversity Policies and Practices of Entities Regulated by the Agencies](#) (June 2015) provides guidance and a framework to enable banks to voluntarily assess their diversity and inclusion practices in the following areas:

- Organizational commitment to diversity and inclusion
- Workforce profile and employment practices
- Procurement and business practices-supplier diversity
- Entities' self-assessment

[NASDAQ Board Diversity Rule](#) (August 2021) requires NASDAQ-listed companies to:

- Publicly disclose board-level diversity statistics using a standardized template; and
- Have or explain why they do not have at least two diverse directors.

Smaller Reporting Companies and Foreign Issuers can meet the diversity objective by including two female directors, and companies with five or fewer directors can meet the diversity objective by including one diverse individual.

Various states, such as California, Washington, and New York also have moved in the direction of mandating board diversity and disclosure requirements. See, e.g., [Letter to The Chief Executive Officers or the Equivalents of New York State Regulated Banking Institutions and Regulated Non-Depository Financial Institutions Re: Diversity, Equity and Inclusion and Corporate Governance](#), July 29, 2021.

In this regard, see [AABD's December 3, 2021 request](#) for guidance from the NYDFS on Diversity Requirements.

## 5. ARTIFICIAL INTELLIGENCE (AI)

**The New Concept:** Machine AI is perhaps the most important and threatening technological development that humans ever have encountered. Although current technology is at a rudimentary stage of machine learning, experts predict that artificial general intelligence – the ability of machines to think, learn, and deduce like a human brain – is coming.

**Potential Impact for Directors:** We should assume that as AI is increasingly embedded into the everyday aspects of a financial services company's operations and decisions, the use of it will impact corporate and board decisions, responsibilities, and obligations, and raise significant issues for directors, including:

1. Can AI enhance corporate governance and performance?
2. Can AI better identify customer investment strategies?
3. Can the use of AI increase the liability of directors –
  - a. What if AI is biased and causes a bank to run afoul of various anti-discrimination laws?
  - b. What if it is simply wrong or biased, and increases corporate risk on the balance sheet?
  - c. What if a bank doesn't use it and fails because it did not see risks or solutions that AI could have identified?
4. Is AI a "person" for purposes of the law, and how does that impact director liability?

**Reference Material:** There is little, if any, law regarding these specific issues that does not revert to the basic concepts of fiduciary duties and require boards to use prudent judgment informed by what a reasonable person would rely on and do. But there eventually will be conflicts over the standards of liability that are chosen.

Rick Hoel, "[Artificial Intelligence and the Board of Directors](#)," *Diligent Insight*, October 22, 2019

Akshaya Kamalnath, "[The Perennial Quest for Board Independence: Artificial Intelligence to the Rescue?](#)" Harvard Law School Forum on corporate Governance, May 1, 2019.

Candace Jones, *Director's Technology Handbook*, ABA 2021



Herbert Zeck, "[Liability for AI: Public Policy Considerations](#)," January 7, 2021

White & Case, "[AI in the Boardroom: Opportunities & Challenges](#)," November 19, 2020.

Shani R. Else, Francis G.X. Pileggi, "[Corporate Directors Must Consider Impact of Artificial Intelligence for Effective Corporate Governance](#)," February 15, 2019

Iakovina Kindylidi, "[Smart Companies: Company & board members liability in the age of AI](#)"

Michael Hilb, "[Toward artificial governance? The role of artificial intelligence in shaping the future of corporate governance](#)"

Olga Sushkova, "[Legal forms and ways of application of artificial intelligence technology in making corporate decisions by the board of directors: problems and prospects](#)"

Iria Giuffrida, "[Liability for AI Decision-Making: Some Legal and Ethical Considerations](#)," Fordham Law Review, 2019

Vikram R. Bhargava and Manuel Velasquez, "Is Corporate Responsibility Relevant to Artificial Intelligence Responsibility? The Georgetown Journal of Law & Public Policy, Vol. 17:829

Lawrence B. Solum, "Legal Personhood for Artificial Intelligence," 70 N.C. L. REV. 1231, 1248 (1992).

James Vincent, "[Giving Robots 'Personhood' Is Actually about Making Corporations Accountable](#)," The Verge, January 19, 2017

## 6. THE PLATFORM CORPORATION

**The New Concept:** A platform business is a business model (not a technology infrastructure) that focuses on helping to facilitate interactions across many participants. These interactions could take the form of short-term transactions like connecting buyers and sellers, or they could involve formation of longer-term social relationships or other constituent relationships.

But platform companies do more than merely utilize new technologies to facilitate economic or social interactions between interested third parties. These companies also organize their internal operations in a flatter and more inclusive way, to enable collaboration among multiple stakeholders. By doing so, they maximize opportunities to deliver constant innovation in platform services and functionality.

**Potential Impact for Directors:** Some argue that the shareholder primacy models have a myopic focus on shareholder value, and overly bureaucratize organizations to entrench

inefficient hierarchies and create a short-term and overly cautious corporate culture. The legal issues that may develop revolve around the requirement to use platforms, particularly to survey and understand the views of constituents. When will a corporation and its directors have a duty to use platform standards when making significant corporate decisions on which the shareholders would not normally vote? What if they do and the decision is challenged? What if they don't? Much like robo-umpires in baseball, the question is whether that ultimately shrinks or enlarges the responsibilities of directors?

**Reference Material:** There is no special law developed on platform corporations. It may turn, in part, on whether the courts adopt other nuances that impact the fiduciary duties of directors, such as ESG.

Mark Fenwick, Joseph A. McCahery & Erik P.M. Vermeulen, "[The End of 'Corporate' Governance: Hello 'Platform' Governance](#)," February 25, 2019.

Deloitte, [New Governance of the Platform Economy](#)