June 2015

Practice Groups:

Labor, Employment and Workplace Safety

Consumer Financial Services

Investment Management, Hedge Funds and Alternative Investments

Federal Financial Regulatory Agencies Release Final Diversity Standards

By George P. Barbatsuly and Joshua D. Rinschler

After lengthy consideration, six federal financial regulatory agencies—the Consumer Financial Protection Bureau, Office of the Comptroller of the Currency, Federal Reserve Board of Governors, Federal Deposit Insurance Corporation, National Credit Union Administration, and Securities and Exchange Commission ("Agencies")—published joint standards on June 9, 2015, for assessing the diversity policies and practices of the entities they regulate in accordance with Section 342 of the Dodd-Frank Act. ("Joint Standards"). The Joint Standards apply to all entities regulated by any of the Agencies, including financial institutions, investment banking firms, mortgage banking firms, asset management firms, brokers, dealers, financial services entities, underwriters, accountants, and investment consultants.

Section 342 of the Dodd-Frank Act required the Agencies to establish an Office of Minority and Women Inclusion (OMWI). Each OMWI is responsible for all matters of the agency relating to diversity and is required to develop standards for assessing the diversity policies and practices of entities regulated by the agency.

On October 25, 2013, the Agencies published proposed standards ("Proposed Standards"), opting to do so jointly in order to promote consistency. The Proposed Standards are described in greater detail here**.** The final standards ("Final Standards") largely track the Proposed Standards, although changes have been made to address more than 200 comments the Agencies received from regulated entities, interest groups, and the general public.

Meaning of "Diversity"

The Proposed Standards did not define the term "diversity." In response to questions raised by commenters about the meaning of that term, the Final Standards define the term to mean "minorities" and "women." The Final Standards define "minority" for purposes of the term "diversity" as "Black Americans, Native Americans, Hispanic Americans, and Asian Americans," which the Agencies note is consistent with how the term is defined in Section 342(g)(3) of the Dodd-Frank Act, but the Agencies note that regulated entities may choose to apply a broader standard.

Applicability to Small Entities/Extraterritorial Application

When drafting these standards, the Agencies focused primarily on institutions with more than 100 employees. Recognizing that small institutions, as well as those in remote locations, face different challenges with respect to diversity efforts, the final Joint Standards encourage "each entity to use these standards in a manner appropriate to its unique characteristics."

In the final Joint Standards, the Agencies also clarify that the Final Standards address only an entity's U.S. operations. However, the Agencies note that this does not preclude a

multinational entity from using these standards to undertake a broader assessment of its organization.

The Joint Standards

Consistent with the Proposed Standards, the final Joint Standards provide guidance in five general categories: 1) organizational commitment to diversity and inclusion, 2) workforce profile and employment practices, 3) procurement and business practices—supplier diversity, 4) practices to promote transparency of organizational diversity and inclusion, and 5) entities' self-assessment.

- **Organizational commitment to diversity and inclusion.** The Joint Standards state that "[t]he leadership of an organization with successful diversity policies and practices demonstrates its commitment to diversity and inclusion. Leadership comes from the governing body, such as a board of directors, as well as senior officials and those managing the organization on a day-to-day basis." Consistent with the Proposed Standards, the Final Standards provide that relevant considerations in this category include whether a regulated entity makes diversity and inclusion considerations in both its employment and contracting decisions, and whether the entity "takes proactive steps to promote a diverse pool of candidates, including women and minorities, in its hiring, recruiting, retention, and promotion, as well as in its selection of board members and other senior leadership positions."
- **Workforce profile and employment practices.** The Joint Standards encourage regulated entities to "use various analytical tools … to track and measure the inclusiveness of their workforce." Again, consistent with the Proposed Standards, the Final Standards state that relevant considerations include whether a regulated entity implements policies and practices related to workforce diversity and inclusion in a manner that complies with all applicable laws, and whether an entity holds management at all levels accountable for diversity and inclusion efforts.
- **Procurement and business practices—supplier diversity.** Consistent with the Proposed Standards, the Final Standards state that relevant considerations in this category include whether a regulated entity has a supplier diversity policy that provides a fair opportunity for minority- and women-owned businesses to compete in procurements of business goods and services and methods to evaluate and assess its supplier diversity.
- **Practices to promote transparency of organizational diversity and inclusion**. The Joint Standards state that "[t]ransparency and publicity are important aspects of assessing diversity policies and practices." Again, as with the Proposed Standards, relevant considerations in this category include whether a regulated entity makes information about its diversity and inclusion efforts publicly available on an annual basis through its website, in promotional materials, and in annual reports to shareholders.
- **Entities' Self-Assessment**. Finally, the Joint Standards provide "[e]ntities that have successful diversity policies and practices allocate time and resources to monitoring and evaluating performance under their diversity policies and practices on an ongoing basis." Considerations include whether "[i]n a manner reflective of the individual entity's size and other characteristics" the entity uses the Joint Standards to conduct self-assessments of its diversity policies and practices annually and whether the entity provides information

pertaining to its diversity efforts to the OMWI of its primary federal financial regulator and the general public. The Agencies estimate that a self-assessment will require approximately 12 hours. In a press release announcing the Joint Standards, the Agencies state that they are asking for public comments on the information collection aspects of the Joint Standards. Comments will be due on August 10, 2015.

Voluntary Standards

The Joint Standards note that their use by regulated entities is voluntary, and that the Agencies "will not use their examination or supervisory processes in connection with these Standards." The voluntary nature of the Joint Standards prompted a sharply worded dissent from SEC Commissioner Luis Aguilar, in which he expressed his view that "[s]imply issuing guidance that relies on a purely voluntary process and hoping that it will work over time will only cause further delay in advancing diversity and inclusion in the financial services industry."

Others, however, have praised the Agencies approach in making the Joint Standards voluntary. In a statement of the National Association of Federal Credit Unions (NAFCU) issued on June 9, 2015, the organization commended the Agencies "for emphasizing that no new legal obligations are being created by the policy statement, as the regulatory burden on credit unions is already far too great." The NAFCU continued, "Credit unions support diversity and have long been, and will continue to be, at the forefront of community involvement and improvement."

In the preamble to the Joint Standards, the Agencies explained that they view a voluntary scheme as "more consistent with the framework set out by the statute." Nonetheless, the Agencies note that the Joint Standards reflect "leading practices with respect to transparency by encouraging the entities to disclose assessment information to the Agencies."

Despite the voluntary nature of the Joint Standards, there are a number of reasons why regulated entities may choose to comply. Institutions that choose to do so may be able to leverage their compliance for marketing and recruiting purposes. Moreover, while the Joint Standards are currently voluntary, there is no guarantee they will remain that way. If the dissent of SEC Commissioner Aguilar gains traction, the Agencies may choose to revisit their voluntary approach in the future, and entities that have been in compliance will be better prepared for any mandatory standards that may be issued. At the same time, voluntary compliance by a substantial number of regulatory entities may ultimately persuade the Agencies that there is no need to revisit the current voluntary nature of the standards.

Additionally, while the Agencies expressly commit to not using their examination or supervisory standards in connection with the Standards, that does not necessarily prevent third parties from doing so. The Agencies recognize that at least some information regulated entities choose to submit pursuant to the Joint Standards may be obtainable under the Freedom of Information Act (FOIA). It is conceivable that the plaintiff's employment bar may seek to use the absence of a filing by a regulatory entity as a basis for challenging the employment practices of the entity.

Concerns Remain

Although there are many good reasons to comply with the Joint Standards, entities that choose to do so should proceed with caution. The Joint Standards have addressed some of

the criticisms contained in many of the comments on the Proposed Standards, but concerns remain. While the Agencies state that regulated entities may designate all self-assessment information provided to the Agencies as confidential commercial information under FOIA, such information could be accessed pursuant to a FOIA request should a court disagree with an entity's designation of information as confidential.

In addition, it remains unclear how the Agencies will use the information disclosed. Consistent with the Proposed Standards, the Joint Standards note that Agencies may use any information disclosed by regulated entities "to monitor progress and trends in the financial services industry with regard to diversity and inclusion in employment and contracting activities," and the Agencies "will share information with other agencies when appropriate." The Joint Standards do not specify which other agencies may be provided with this information, and it is conceivable that such information could be made available to the Equal Employment Opportunity Commission or the Department of Labor. These other agencies, in turn, would potentially be in a position to use information provided under the Joint Standards in lawsuits against regulated entities in furtherance of these other agencies' independent litigation authority.

Regulated entities will need to balance a number of potentially competing considerations in deciding whether to comply with the Joint Standards. Those that choose to do so may wish to involve legal counsel in formulating an appropriate compliance strategy.

Link to final standards

Authors:

George P. Barbatsuly
george.barbatsuly@klgates.com
+1.973.848.4104

Joshua D. Rinschler
joshua.rinschler@klgates.com
+1.973.848.4145