



CORPORATE GOVERNANCE



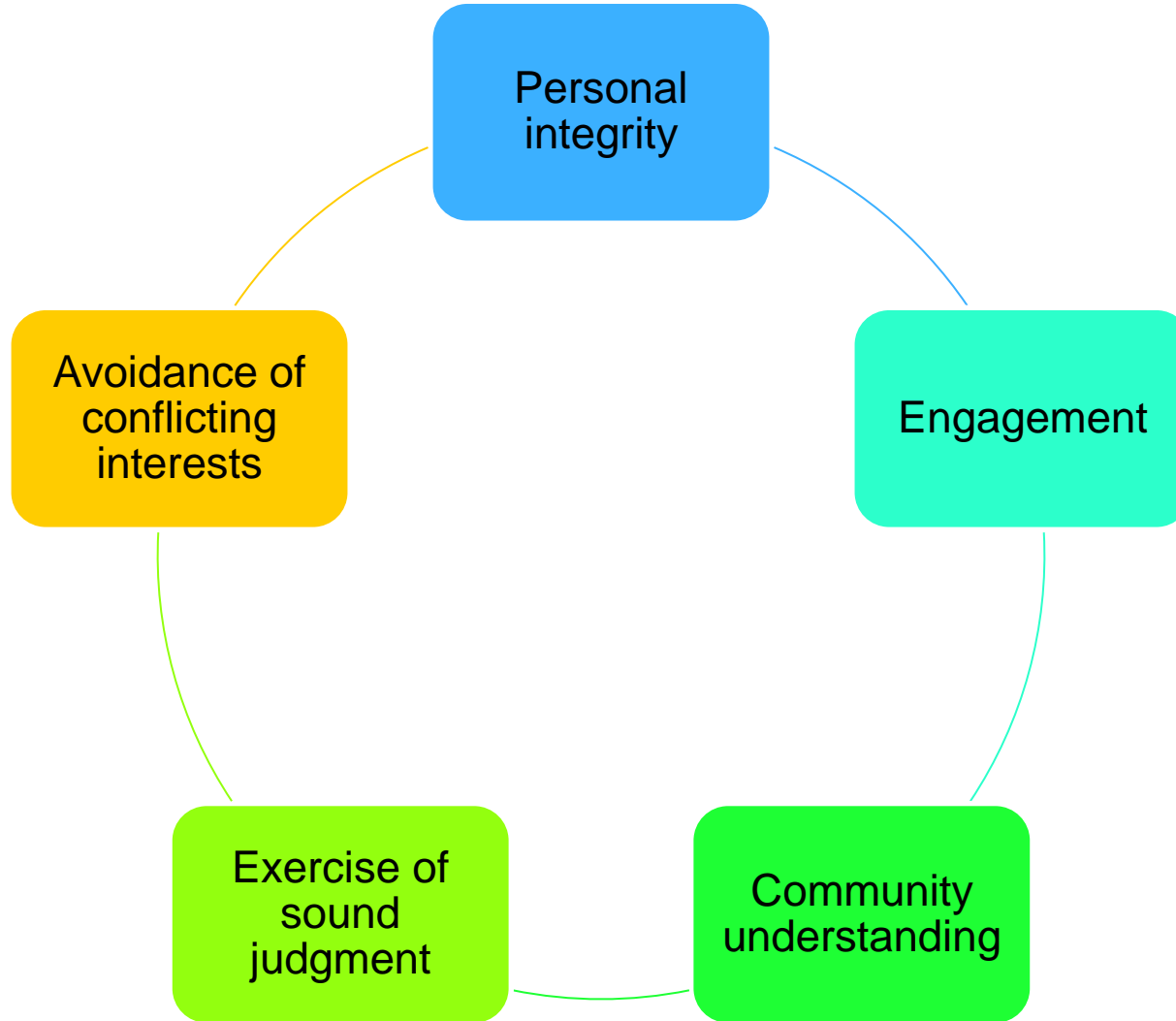


Corporate Governance

*The roles and responsibilities of
community bank directors and
senior managers.*

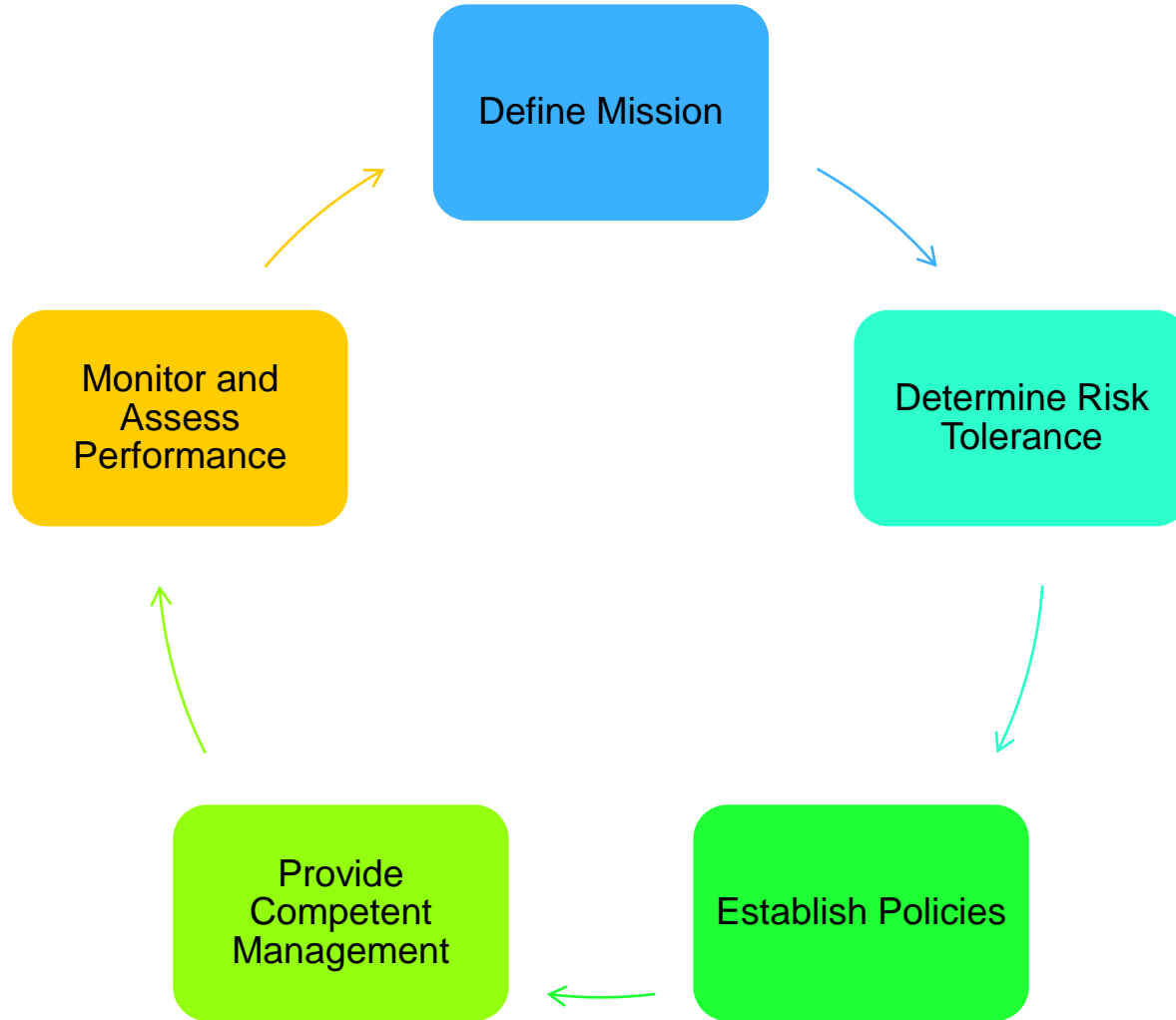


Principles



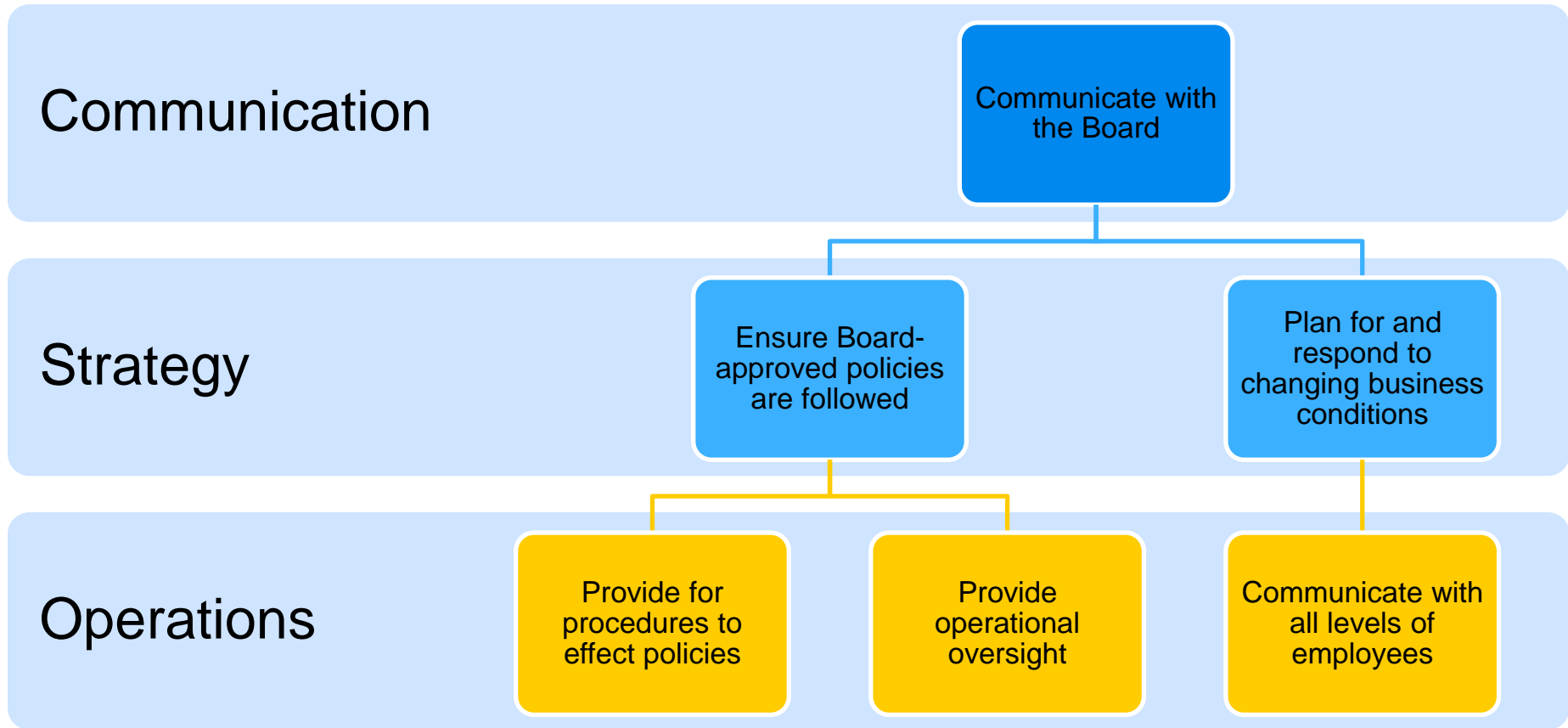


Director Responsibilities





Manager Responsibilities





Risk Management Process





Risk Management Process

**How many
are you doing
already?**

- **Risk Assessment?**
- **Control Testing?**
- **Risk Mitigation?**



Importance of Risk Management

Companywide Risk Management

- Reveals foreseeable risks
- Offers a system-wide set of solutions that support the objectives of all departments
- Encourages coordination and collaboration between departments
- Aligns strategy, processes, technology, and people.



Risk Identification





Has Your Bank Identified Its Risks?

Types Of Risk

- Operational risk
- Strategic risk
- Reputation risk
- Electronic/Mobile Banking risk
- ACH risk



Risk Identification

Common risks for Banks

- Asset quality concerns
- Concentrations – assets, liabilities, income
- Interest rate risk in a changing rate environment
- Excessive reliance on volatile funding sources
- Internal control deficiencies
- Compliance-RESPA, UDAAP, TIL, Fair Lending, SAFE, Others



Risk Identification

Emerging Industry Risk Examples

- Sensitivity to interest rate risk
- Technological risks
- New products
- Generational differences in your customers
- Fee income reliance
- New and revised consumer protection laws
- Third party risks-Legal, Reputational, Compliance



Risk Assessment





Risk Assessment Drives Control

Risk Assessment

- **The basis for policies, procedures, and controls**
- **Integral in the decision making process**
 - ◆ New products
 - ◆ New services
 - ◆ New technological investment
 - ◆ Resource allocation
- **Not all risks are equal**
 - ◆ Critical risks
 - ◆ Emerging
 - ◆ Non-critical



Types of Risk

■ **Key Risks**

■ **Or**

Emerging

Risks?

- **Bank has heightened sensitivity**
- **Potentially significant impact to the Bank**
- **Meets the definition of a Key Risk and -**
 - ◆ Arises from a newly-developing situation or occurrence
 - ◆ Has a high degree of uncertainty
 - ◆ Does not yet have specific risk management assessments performed or mitigation strategies identified



Types of Risk

- **Material**

- **VS.**

- **Non-Material**

- **Key**
- **Top**
- **Emerging**
- **Critical**
- **Quantitative**
- **Qualitative**
- **Core**
- **Non-core**



Example: Incomplete Risk Identification & Assessment

Bank enters into a relationship with 3rd Party Payment Processor (Debt Settlement Company), but failed to:

- Properly research Section 5 of FTCA and other applicable compliance laws and regulations
- Review national complaint databases and company's own complaint records for recurring (core) problems
- Review company's advertising for deceptive statements
- Review company's responses to past allegations and notifications by Attorneys General offices
- Ensure company is adhering to license requirements for states in which it is active

Focusing solely on income stream, the bank failed to appropriately assess the reputation and legal risks associated with this relationship.



Challenge Your Risk Assessment Regularly

Determine risk materiality-don't major in the minors

Maintain a list of material risks and their mitigating controls identified across all corporate functions and business units

Assess and review your process to ensure that all risks across the institution are identified

Evaluate for materiality, mitigation, management, and capital considerations....Challenge the Assessment



Challenge Your Risk Assessment

■ Challenging Your Risk Assessments

- Are the risks properly identified and categorized (high, medium, low, critical, emerging etc.) for each area?
- Do identified controls make sense and are they sufficient?
- Encourage a **SINGLE** Risk Assessment for the entire bank
- Update the Risk Assessment regularly



Example of Basic Risk Assessment Matrix

Your Risk *Assessment* Can Be As Simple As

LOW

MEDIUM

HIGH

But: your assessment **MUST** contain associated mitigating controls for each identified area.



Risk Assessment

Your Risk Assessment is a dynamic document that should be:

- Reviewed regularly
- Updated for audit and examination findings
- Updated for changing products/services/strategies
- Adjusted every time a new risk or mitigating control is identified



Risk Tolerance





Risk Tolerance

**How Much Risk Are
We Willing to Take
In Any Given Area?**



Risk Tolerance

**For any risk
limit to be
useful,
it must be:**

- **Understood by management and the Board**
- **Capable of being measured with existing risk measurement tools**
- **Stated relative to meaningful values, such as earnings or capital**



Risk Tolerance



Need consensus



Must communicate risk tolerance decisions throughout the institution

Why?

Effective communication goes beyond the “Do’s” and “Don’t” and explains the “WHY”



Governance & Policies





Governance & Policies

How do you connect strategy (appetite) and operations (exposure)?



By establishing policies that support the agreed upon risk tolerance

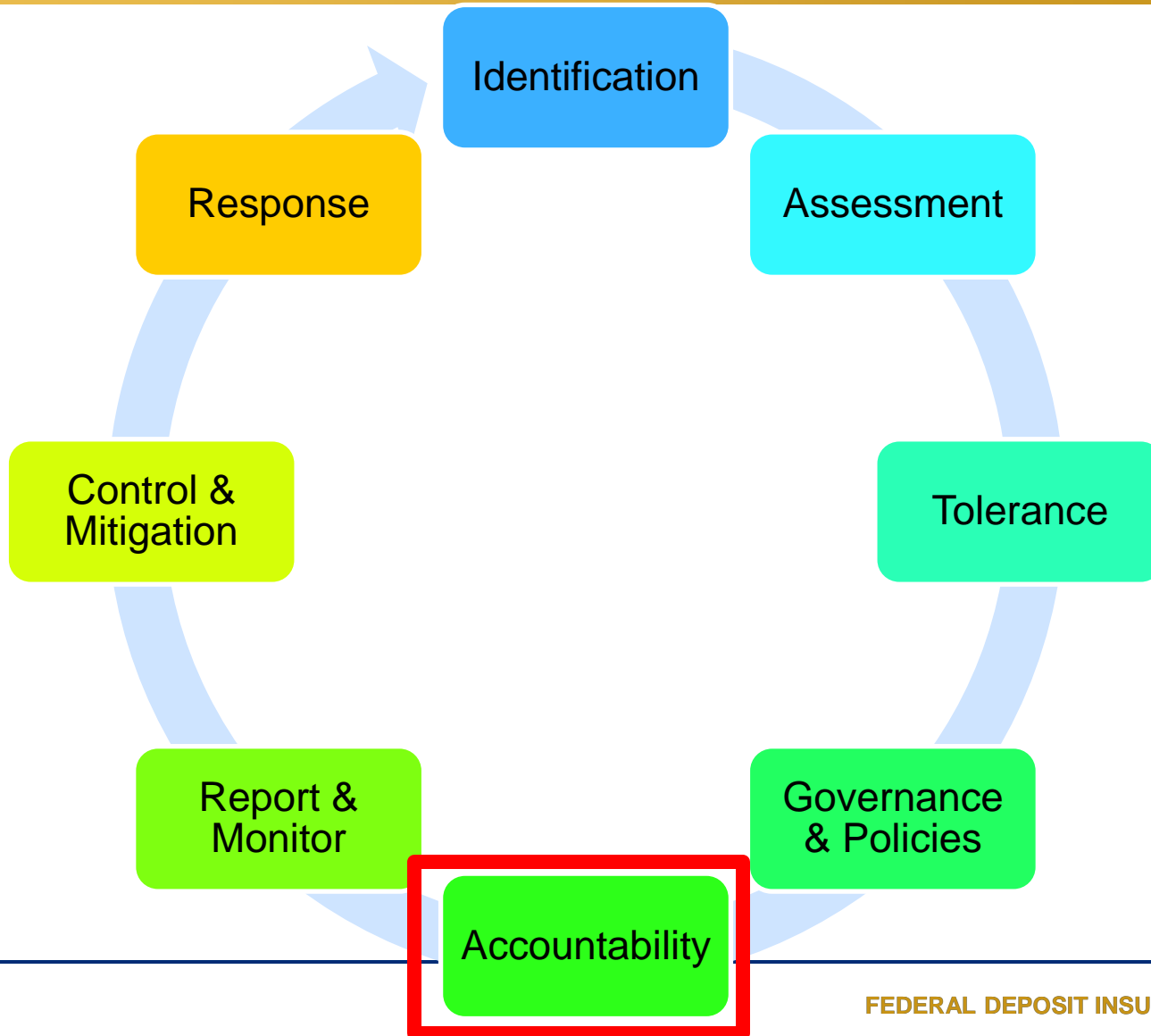


Policies & Procedures

- **Do your policies and procedures sync?**
- **Are they effective?**
- **Do they accomplish what they are meant to do?**
- **Are there disconnects?**
- **Do policies assign accountability?**
- **What will you do about it?**



Accountability





Accountability

Clearly identify responsibilities

Provide for training, as needed

Build risk management specifically into job responsibilities and compensation



Accountability

**Who is
accountable?**

- **Board of Directors**
- **Committee – Board level,
Management level**
- **Executive Management –
President, Chief Risk Officer,
Audit Director, Chief Credit
Officer, Etc.**
- **Mid-Level Management**
- **Staff**



Reporting & Monitoring





Risk Reporting and Monitoring

**Ask yourself,
“Does this report
tell me anything
about whether
operations are
aligned with my
risk tolerance?”**

- **Management Information Systems**
- **Appropriate detail in reports**
- **Accurate reports**
- **Appropriate timing of reports (monthly, quarterly, etc.)**



Risk Reporting and Monitoring (Continued)

**Ask yourself,
“Does this report
tell me anything
about whether
operations are
aligned with my
risk tolerance?”**

- **Comparison to risk tolerance triggers, limits, and parameters**
- **Back testing**
- **System capacity analysis**



Internal Reports

■ **Internal**

■ **Vs.**

■ **External**

- **CREDIT-** watch list, non-accrual reports, ALLL analysis, credit approval memoranda
- **LIQUIDITY-** investment activity reports, liquidity analysis
- **IRR MODELING-** Earnings at Risk, EVE
- **AUDITS-**Test Your Controls
- **INDEPENDENT REVIEWS**



External Reports

■ **Internal**
■ **Vs.**
■ **External**

- **Loan reviews**
- **Audits**
- **Independent reviews**
- **Exams**



Control & Mitigation





Risk Control & Mitigation

Controlling Risks

- Test controls-Audit
- 3rd party relationships in audit coverage?
- Frequency of high risk area audit-DO WE TEST ENOUGH?
- Scheduling



Risk Control & Mitigation

Controlling Risks

- Do we offer enough training to our staff?
- Do we educate our customers?
- Do we have appropriate controls in place?
- Do our policies identify proper procedures?



Response





**What are we
doing about
individual
risks?**

- **Are mitigants/controls adequate?**
- **Has our risk appetite changed?**
- **Does our policy need to be amended?**
- **Make changes as appropriate to all areas.**



Response – TRACK IT!

**When an
exception is
noted:**

- **Determine level of risk**
- **Determine corrective action**
- **Assign accountability**
- **Assign a timely due date for action**
- **Have independent person verify correction**
- **Maintain a list of outstanding items**



Communication

When the Risk Management program and strategy can be explained to and understood by:

- The most junior associate,
- The senior management, and Board,

an institution-wide acceptance of Risk Management is possible.




As a Board Member...

Understand the highest inherent risk areas of your bank

A large, light blue downward-pointing arrow indicating the flow from the first step to the second.

Understand the associated controls in place to mitigate the highest inherent risk areas of your bank

A large, light blue downward-pointing arrow indicating the flow from the second step to the third.

Ascertain if high risk areas are being monitored properly

**Ask to see
your bank's
Risk
Assessment**

- **Does it make sense to you?**
- **Are high risk areas and mitigating controls identified?**



As a Board Member...

While some processes can be outsourced, ultimate responsibility for risk identification, mitigation, and regulatory compliance rests with the Board.

Getting answers to your questions is critical.



Lessons from Recent Failures

- **Aggressive growth**
- **Excessive concentrations**
- **Inadequate underwriting guidelines**
- **Excessive reliance on volatile funding sources**
- **High risk business plan**
- **Underfunded ALLL**
- **Management issues**

- **Questions?**





Take Home Messages:

- 1. Ask to see a Risk Assessment for your bank.**
- 2. Is it your bank's or vendor provided?**
- 3. Are the highest risk areas getting appropriate attention?**
- 4. Are mitigating controls identified?**
- 5. Is the audit program adequate?**
- 6. Avoid "majoring in the minors"**



References

- **FDIC Rules and Regulations Part 364**
- **Conference of State Banking Supervisors white paper “*The Case for Stress Testing at Community Banks*” issued October 20, 2010**
- **Office of the Inspector General, Office of Audits and Evaluations, Report No. EVAL-13-001, *Acquisition Development, and Construction Loan Concentration Study* (October 2012)**
- **United States Government Accountability Office *FINANCIAL INSTITUTIONS Causes and Consequences of Recent Community Bank Failures*, June 13, 2013, Highlights of GAO-13-704T, a testimony before the Committee on Banking, Housing and Urban Affairs, U.S. Senate**
- **Office of Inspector General Department of the Treasury Audit Report *SAFETY AND SOUNDESS: OCC Identification of Emerging Risks* (OIG-13-037), April 9, 2013**
- **The Office of the Comptroller of the Currency (OCC) Bulletin OCC 2012-33, “*Community Bank Stress Testing: Supervisory Guidance*”**
- **www.fdic.gov - FDIC Technical Assistance Video Program online videos**