Corporate Governance

ROLES / RESPONSIBILITIES / RISKS

Directors owe their Institution

DUTY of CARE: Maintain reasonable supervision of the activities and affairs of the institution.

DUTY of LOYALTY: Ensure decisions are not governed by self-interest.

Principles of Strong
CORPORATE GOVERNANCE

- Personal Integrity
- Interest in Duties & Responsibilities
- Avoidance of Conflicts of Interest
- Sound Business Judgement
- Familiarity with the Community
- Independent Decision Making

SUPERVISION of BANK AFFAIRS

- Establish Policies
- Monitor implementation
- Provide for independent review
- Heed supervisory reports

Responsibilities of Bank Directors

- Establish appetite for risk
- Select competent management and monitor their performance
- Establish business strategies and policies
- Make fully informed business decisions
- Monitor and assess the progress of business operations
- Establish and monitor adherence to policies and procedures required by statute, regulation, and principles of banking
- Serve the community

Responsibilities of

MANAGEMENT

- Keeps Board apprised
- Provides operational oversight
- Complies with law, regulations, and internal policies
- Plans for and respond to changing business conditions
- Responds to recommendations from auditors and regulators
- Serves the community
- Avoids self-dealing
- Strong bank performance and risk management

STANDARDS for SAFETY & SOUNDNESS Per PART 364, Appendix A

1. Internal Control and Information Systems
2. Internal Audit System
3. Loan Documentation
4. Credit Underwriting
5. Interest Rate Exposure
6. Asset Growth
7. Asset Quality
8. Earnings
9. Compensation, Fees and Benefits

Board Approved Policies and Procedures

Structure of the Balance Sheet

Type and Quality of Assets and Liabilities

Earnings, Liquidity, IRR

Ability to generate Capital and pay Dividends

STRATEGIC RISK

- Determine where are you now --where you want to be -- how do you get there
- Assess the costs/benefits or risk/return
- Establish policies and procedures
  - Reflects both business intent and commitment to your community
  - Clarifies tolerance for risk
  - Recognizes interrelationship between all functional areas of the institution
  - Flexible to respond to changing business conditions and to permit innovation
- Review regularly to ensure appropriate for current conditions and appetite for risk

Assessing your
RISK PROFILE

- How much risk are you operating with?
- What are the current results?
- Where will this plan take you in the future

COMMON RISKS

- Excessive growth
- Management issues – dominant management, high risk appetite, change of business plan, unresponsive to prior recommendations, excessive compensation
- A significant increase in the volume of low quality loans
- Concentrations of assets for which valuation methods are complex or uncertain
- Excessive reliance on volatile funding sources
- Overemphasis on earnings at the expense of safety and soundness
- Basic internal controls deficiencies
- Significant insider transactions that are not properly approved or fully documented
- High volume of consumer complaints

Setting your

APPETITE for RISK

- **Identify (Risk Assessment)**
- **Measure (Risk Exposure)**
- **Monitor (Risk Focus)**
- **Control (Risk Minimization)**
- **Manage (Risk Management)**

CONSIDERATIONS for

RISK PARAMETERS

- Business Lines
- Match business opportunities to community needs
- Determine risk and set risk limits
- Diversification
- Economic Considerations
  - Factors you can control
  - Factors you cannot control
- Competition
- Individual Considerations

CONSIDERATIONS for

RISK PARAMETERS

Look at the Forest

- Risk Management requires you to set the Strategic Goals and Objectives

But Also Check the Health of the Trees

- Risk Management entails thinking how each action affects all areas of the Bank

Strong
Risk Management Program

- Considers Business Lines
- Determines Risks and Sets Risk Limits
- Matches Opportunities to Community Needs
- Diversifies Balance Sheet
- Analyzes Economic Factors
  - Those you can control
  - Those you cannot control

The 5 P's of Risk Management

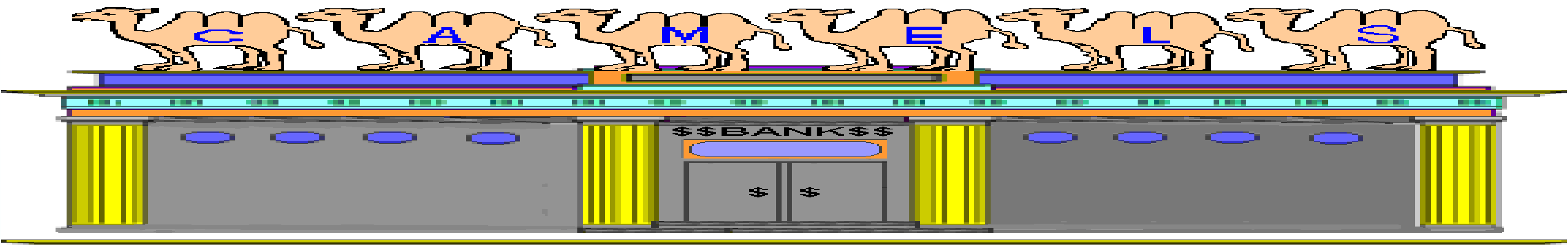
1) *Proactive planning*
2) *Policies/practices*
3) *Parameters*
4) *Protection*
5) *Prospects*

RISK MANAGEMENT PROGRAM

- IDENTIFY
- MEASURE
- MONITOR
- CONTROL

RISK MANAGEMENT PROGRAM

- Risk must be properly identified, managed, monitored, and controlled
- Review regulatory guidance addressing emerging issues/risks
- Prompt responses to weak risk management practices



CAMELS COMPONENTS

CAPITAL

ASSETS

MANAGEMENT

EARNINGS

LIQUIDITY

SENSITIVITY TO MARKET RISKS

The strength of risk management practices is considered in the "M" or Management component rating

Common Characteristics of Problem Banks

- Excessive Growth
- High Concentrations
- Inadequate Credit Administration and Underwriting
- Excessive volatile funding
- Deviations from Business Plan
- Underfunded ALLL / Poor Methodology
- Management Deficiencies

MONITORING TOOLS

- **Internal Reports**: Financial Statements, Overdrafts, Watch List, Past Due, Non Accrual, ALLL Analysis, Investment Activity, IRR Model, Insider Transactions

- **External Reviews:** Loan Reviews, Audit Reports, Regulatory Examinations

- **Financial Analysis:** Balance Sheet, Income Statement, Key Ratios

	5/31/11	4/30/11	3/31/11	2/28/11	1/31/11	12/31/10
Tier One Capital to Total Assets	7.38	7.44	7.73	8.36	8.54	8.95
Asset Growth Rate	17.55	20.67	30.35	22.42	14.89	11.83
Allowance for Loan Loss to Total Loans (ALLL)	0.90	0.92	0.99	1.00	0.96	0.88
Non-current Loans to Gross Loans	2.10	1.23	0.96	0.72	0.55	0.37
Net Loan Losses to Total Loans	0.70	0.45	0.40	0.03	0.00	0.23
Provision for Loan Losses to Total Assets	0.23	0.21	0.22	0.22	0.22	0.17
Earnings Coverage of Net Losses	3.07	5.14	5.67	40.00	N/A	11.31
Net Income to Total Assets (ROA)	0.50	0.58	0.57	0.62	0.58	0.96
Net Interest Income to Earning Assets (Net Interest Margin)	3.80	3.98	4.06	4.20	4.18	4.58
Net Non Core Funding Dependence	15.37	15.84	7.33	11.36	14.56	15.64
Cash, Securities, & Federal Funds Sold to Total Assets	22.13	27.07	33.60	32.60	29.59	26.80
Net 1 year Position to Total Assets	13.29	12.19	10.55	10.27	10.15	9.92

MATERIAL LOSS REVIEWS

MLR FINDINGS

COMMON CHARACTERISTICS

- Aggressive Growth
- Excessive Asset Concentrations (CRE/ADC)
- Inadequate Credit Administration/Underwriting
- Excessive Concentration of Volatile Funding
- High Risk Business Plan
- Underfunded ALLL / Poor Methodology
- Management Issues

HIGH RISK PROFILES

- Risk arising from an organizations:

Strategic Goals → Implementation Strategies → Contingency Plans

  - Current and prospect impact to CAMELS
  - Imprudent implementation
  - Lack of responsiveness to economic changes

LESSONS LEARNED

- Understand your Risk Profile
- Understand Level and Trend of your Risks
Low–Medium–High Historical–Current–Future
- Act Before Issues Manifest into Problems

All MLRs are publicly available online at:

www.fdicoig.gov/MLR.shtml

RISK & CONSEQUENCES

REGULATOR

BOARD

MORTGAGE LENDING

MORTGAGE LENDING

- Management Expertise
- Community Reinvestment Act (CRA)
- Earnings
- Consumer Compliance Regulations
- Reputational Risk

FUNDING SCENARIO

FUNDING SCENARIO

- Cost of Funds
- Diversification
- Interest Rate Risk
- Decline in Asset Quality
- Market / Economy Changes

QUESTIONS

ROLES / RESPONSIBILITIES / RISKS