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

- Personal integrity
- Avoidance of conflicting interests
- Exercise of sound judgment
- Engagement
- Community understanding
Director Responsibilities

Define Mission

Determine Risk Tolerance

Monitor and Assess Performance

Provide Competent Management

Establish Policies
Manager Responsibilities

Communication

- Communicate with the Board

Strategy

- Ensure Board-approved policies are followed
- Plan for and respond to changing business conditions

Operations

- Provide for procedures to effect policies
- Provide operational oversight
- Communicate with all levels of employees
Risk Management Process

- Identification
- Assessment
- Tolerance
- Governance & Policies
- Accountability
- Report & Monitor
- Control & Mitigation
- Response
Risk Management Process

How many are you doing already?

- Risk Assessment?
- Control Testing?
- Risk Mitigation?
Importance of 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

- Identification
- Response
- Assessment
- Control & Mitigation
- Tolerance
- Report & Monitor
- Governance & Policies
- Accountability
Has Your Bank Identified Its Risks?

- 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

- Identification
- Assessment
- Governance & Policies
- Tolerance
- Control & Mitigation
- Report & Monitor
- Accountability
- Response
Risk Assessment Drives Control

- 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

- 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
Your Risk Assessment Can Be As Simple As

- LOW
- MEDIUM
- HIGH

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

- Identification
- Assessment
- Tolerance
- Control & Mitigation
- Response
- Governance & Policies
- Report & Monitor
- Accountability
Risk Tolerance

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

- Identification
- Response
- Control & Mitigation
- Report & Monitor
- Accountability
- Assessment
- Tolerance
- Governance & Policies
How do you connect strategy (appetite) and operations (exposure)?

By establishing policies that support the agreed upon risk tolerance.
- 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

- 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
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
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
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.
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

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

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

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