Community Bank Corporate Governance

Corporate Governance

Core concepts for effective corporate governance:

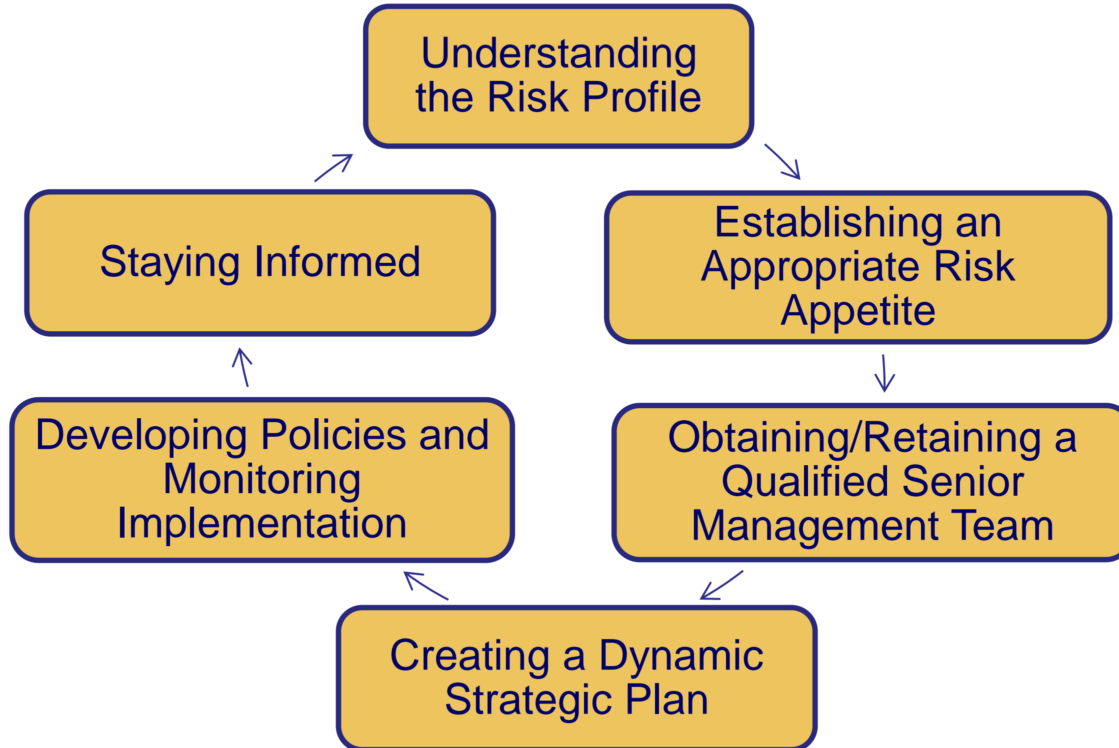
- ✓People;
- ✓Policies; and
- ✓Processes.

Corporate Governance Framework

A corporate governance framework should be:

- Functionally sound; and
- Appropriate for the bank's size, complexity, and risk profile.

Key Elements of a Corporate Governance Program



Director Roles and Responsibilities

Four important pieces of guidance describe the basis for the FDIC's expectations regarding directors:

- The Pocket Guide for Directors (Originally issued in 1988);
- FDIC Statement Concerning the Responsibilities of Bank Directors and Officers (FDIC Statement of Policy);
- Corporate Codes of Conduct, Guidance on Implementing an Effective Ethics Program (FIL-105-2005); and
- The Interagency Guidelines Establishing Standards for Safety and Soundness (12 C.F.R. Part 364, Appendix A of the FDIC Rules and Regulations).

Pocket Guide for Directors

Hiring and retaining qualified senior management	Establishing long- and short-term business objectives	Adopting policies to achieve objectives in a legal and sound manner
Monitoring operations and compliance with policies and regulations	Overseeing the bank's business performance	Keeping informed
Avoiding preferential transactions	Ensuring the bank helps meet the credit needs of its community	Exercising independent judgment

Statement Concerning Responsibilities of Directors and Officers

Directors and officers have a duty to exercise loyalty and care when fulfilling their responsibilities.

Loyalty — Administer the affairs of the bank with candor, honesty and integrity. Prohibited from advancing their own personal or business interests at the expense of the bank.

Care — Exercise sound business judgment. Employ the same degree of care as a prudent individual. Act in good faith and in the best interest of the bank.

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Ethics Policy

Key Elements of a Corporate Governance Program

Understanding the Risk Profile

→ Establishing an Appropriate Risk Appetite

→ Obtaining/Retaining a Qualified Senior Management Team

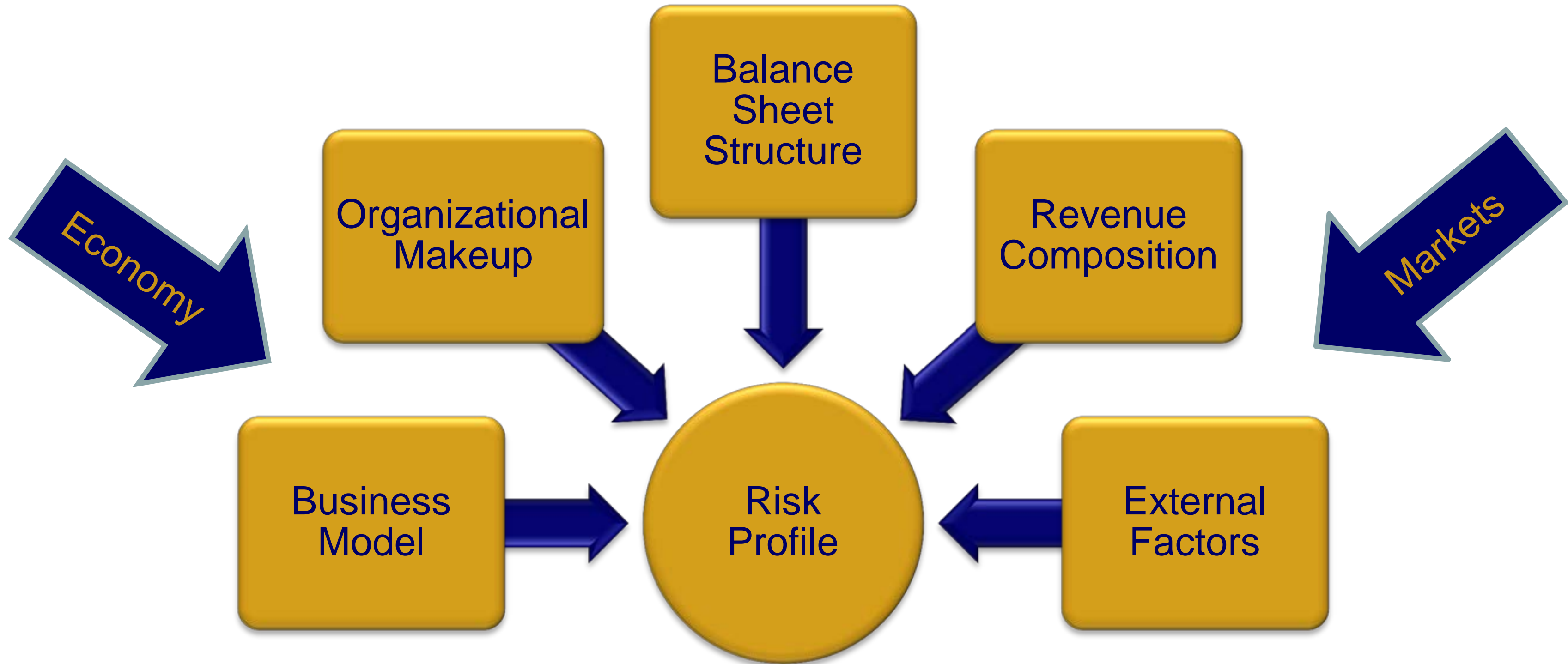
→ Creating a Dynamic Strategic Plan

→ Developing Policies and Monitoring Implementation

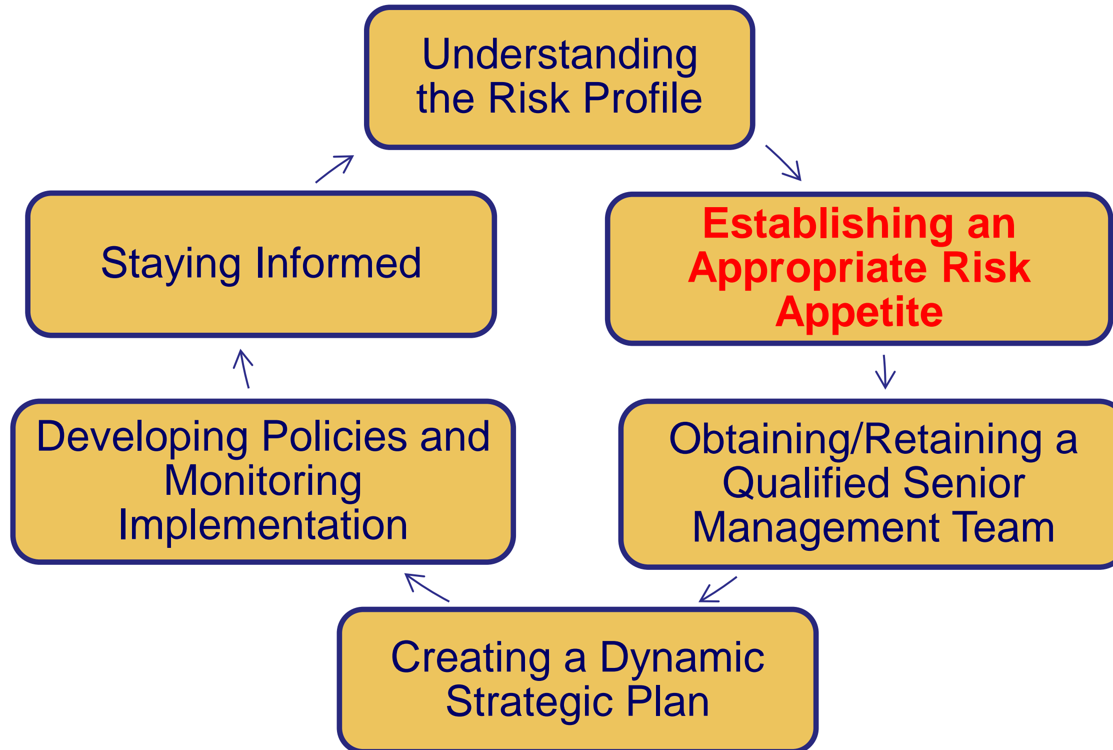
→ Staying Informed

→ Understanding the Risk Profile

Assessing the Bank's Risk Profile



Key Elements of a Corporate Governance Program



Risk Appetite

Risk appetite is the level of risk a board of directors is willing to assume in order to achieve its strategic objectives and business plan.

- Directors should consider the trade-off between risk and return and the effect a chosen risk appetite could have on the bank's ability to withstand periods of economic stress or other challenges.

- A board's chosen risk appetite should be properly supported by a bank's capital, income, and management expertise.

Key Elements of a Corporate Governance Program

Understanding the Risk Profile

Establishing an Appropriate Risk Appetite

Obtaining/Retaining a Qualified Senior Management Team

Creating a Dynamic Strategic Plan

Developing Policies and Monitoring Implementation

Staying Informed

Selection of Senior Management

- The number of senior management positions and the level of management expertise should be appropriate for the bank's size, complexity, and risk appetite.

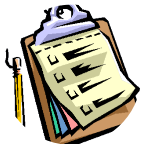
- The management team structure should be re-evaluated when:
  - New initiatives and product lines are being considered;
  - Emerging risks are identified;
  - Material changes in technology occur; or
  - Markets expand.

Effective Personnel Administration

Clear Organizational Structure

Detailed Position Descriptions

Sound Compensation Policies

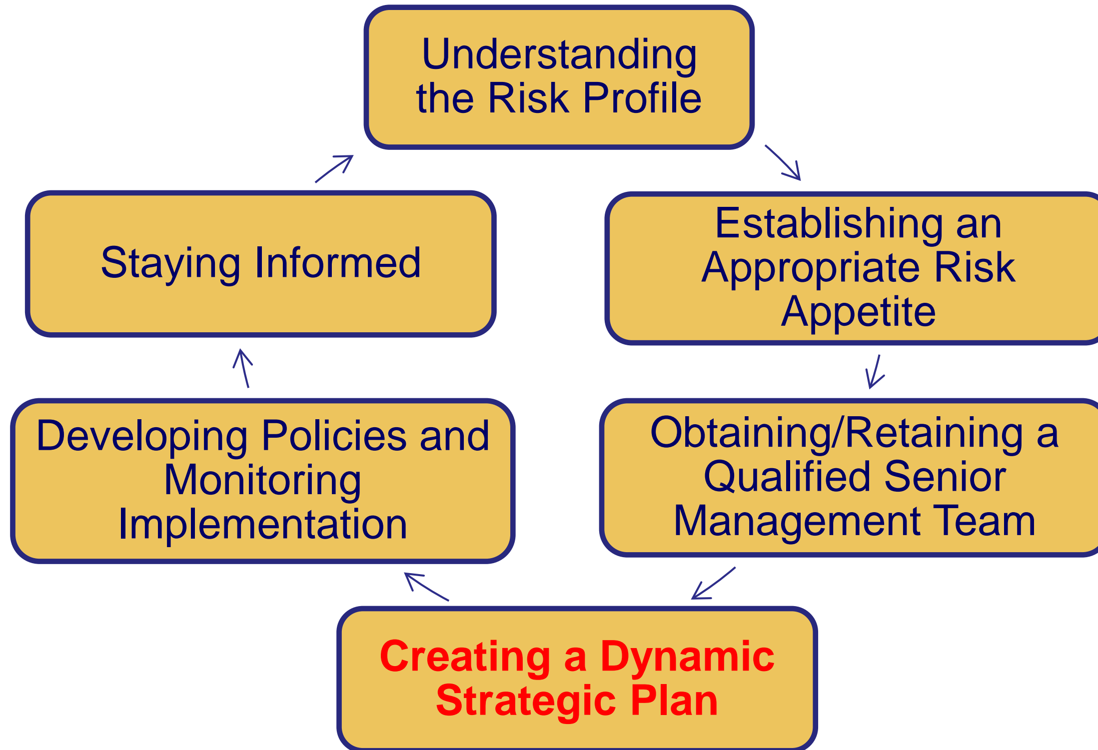


Regular Performance Evaluations

Strategies for Management Succession

Planning	Identifying and Assessing Potential Successors	Training, Mentoring, and Developing Employees
• Identify Key Management Positions • Document Specific Sources for Successors • Identify Available Developmental and Training Opportunities	• Within the Bank • Outside the Bank	• Cross-training • Committee Participation • Special Projects • Mentoring/Coaching Relationships

Key Elements of a Corporate Governance Program



Strategic Planning Process

The planning process is driven by the bank's:

- ✓ Culture
- ✓ Mission
- ✓ Business Model
- ✓ Risk Appetite
- ✓ Available Resources
- ✓ Risk Profile
- ✓ Size
- ✓ Geographic Location
- ✓ Communities Served

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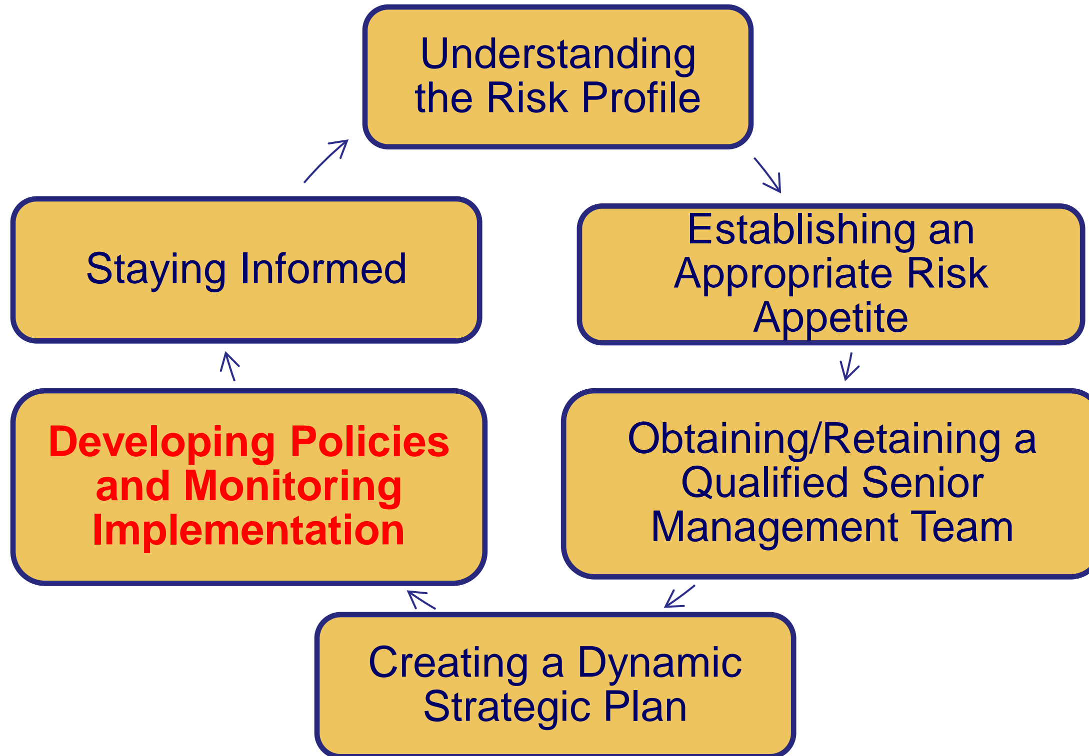
Strategic Plan

The board and senior management should develop a well-constructed strategic plan that:

- Is based on realistic assumptions;
- Includes clear objectives, well-defined risk limits, and measurable goals; and
- Is periodically reviewed and updated to address changing circumstances or new strategies.

Key Elements of a Corporate Governance Program



Safety-and-Soundness Standards

Section 39 of the FDI Act requires banks to maintain certain safety-and-soundness standards. These standards, which are included in Appendix A of Part 364 of the FDIC Rules and Regulations, provide supervisory expectations for many critical operating areas.

- Internal controls and information systems;
- Internal audit;
- Loan documentation;
- Credit underwriting;
- Interest rate exposure;
- Asset growth;
- Asset quality;
- Earnings, and
- Compensation, fees, and benefits.

Internal Control System

Internal Audit Program

- Independent, sufficiently staffed, and commensurate with the community bank’s operations;
- Periodically reviewed and revised, as needed, to cover new product lines, to address higher-risk activities, and to include other emerging areas of concern; and
- Provide directors with information about emerging risks and operational weaknesses so that prompt, remedial action can be taken.

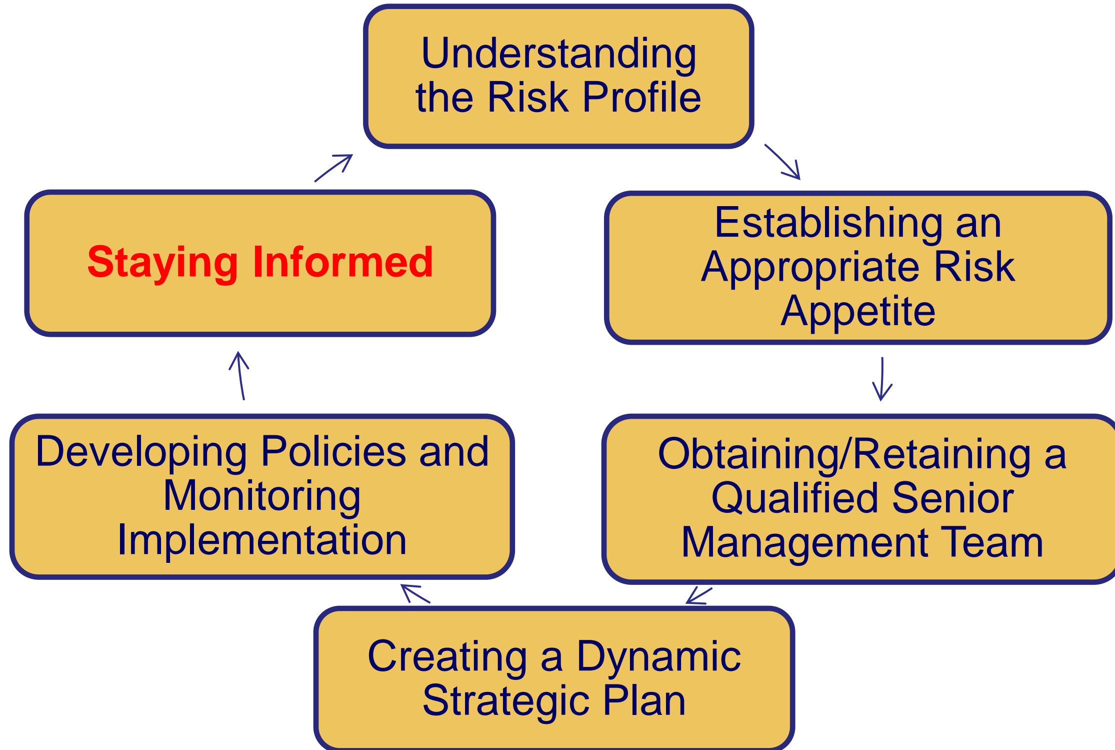
Other Effective Controls

- Annual external audits can be used to review internal controls and management reporting systems.

- Directors should review reports of examination or other correspondence from the bank's regulators.

- Recommendations from auditors and regulators should be tracked to resolution.

Key Elements of a Corporate Governance Program



Preparing for Board Meetings

Prior to attending board meetings, directors should ensure they are provided with appropriate information with sufficient time for review. Board meeting materials should:

- Include financial statements and other reports that present bank performance in light of policy parameters, budget projections, and identified peer groups;
- Address new business activities and products, investment and lending activities, insider transactions, and exceptions to written policies and established risk parameters; and
- Cover results of any completed audit and regulatory examinations and information on important action items.

Board Reports, Briefings, and Other Information Sources

- Board reports should be tailored to meet a director's informational needs. Reports must have sufficient detail to allow directors to properly monitor performance and to ensure risk limits are not exceeded.

- Directors should also stay informed through periodic briefings by senior management and legal counsel, as well as by reviewing internal and external audits and regulatory reports of examination.

FDIC Information Sources

- Regulations, statements of policy, and other supervisory guidance;
- Financial Institution Letters (FILs); and
- Research papers and articles on a variety of banking issues.

Directors' Resource Center

- Virtual Directors' College Program
- Virtual Technical Assistance Program
  - Interest Rate Risk
  - Flood Insurance
  - Fair Lending
- Regulatory News and Events
- Regulatory Guidance

Director Involvement During Examinations

Examiners invite directors, through the bank's senior management, to participate in examination discussions. The invitation is intended to expand communication between outside directors and examiners during the course of safety-and-soundness, compliance, and other specialty examinations.

“*The Risk Management Examination and Your Community Bank*,” Summer 2012 Issue

This article presents an overview of the examination and supervisory process, and suggests ways to enhance communication between bankers and supervisors.

Dominant Director, Officer, or Shareholder

An individual that dominates critical phases of the bank's policies or operations.

Dominant Individuals

Two potential concerns exist with a dominant director, officer, or shareholder.

1. Unexpected departure of the dominant officer may result in a management void.
2. Problems caused by a dominant individual can be more difficult to solve given his/her influence over corrective action.

Mitigating Controls

Controls that can help mitigate dominant influence:

- Segregation of duties and responsibilities;
- A sufficient number of outside, independent, and engaged directors; and
- Independent board committees overseeing major risk areas.

Liability of Bank Directors

- The FDIC does not initiate litigation against directors or officers who do their jobs.
- FDIC lawsuits often result from a director’s or officer’s failure to satisfy the duties of loyalty and care.

Liability of Bank Directors

Lawsuits generally involve situations where directors or officers have:

- Failed to establish, or adhere to, proper policies;
- Disregarded warnings of regulatory authorities or professional advisors;
- Engaged in dishonest conduct or abusive insider transactions; or
- Failed to comply with laws and regulations.

Important Takeaways

- Directors must clearly understand their roles and responsibilities, keep informed, and use independent decision making to set the strategic direction and risk appetite for the bank.
- Directors also have a responsibility to monitor senior management in light of the bank's operational goals and risk limits.
- The FDIC expects that a bank's risk management process will be appropriate for the size, nature, scope, and risk of the bank's activities.

Important Takeaways

- Supervisory Insights, "*Special Corporate Governance Edition*," April 2016 Issue

This issue highlights key governance concepts, roles, and responsibilities of directors and senior management, and discusses how FDIC examiners evaluate governance at community banks.