

HOW TO USE THIS GUIDE

Now that bank directors are held more accountable by the regulators, it is important that bank directors know as much as they can about what bank management is doing to ensure a safe and sound banking environment. To accomplish this end, bank directors should know what their responsibilities are, develop a plan to carry them out, and monitor management's success in performing such duties as risk management, investment management, and overseeing regulatory compliance.

This guide is intended to be used as a “how to guide” and reference source to a bank director's role in his or her bank. New directors may find it particularly useful for determining the scope of their duties and responsibilities as bank directors. Members of various bank committees can refer to individual chapters for guidance on how to carry out their duties. Many chapters contain checklists that can be used to deal with specific situations, such as selecting asset/liability management software. Other chapters, such as those that deal with risk management and insurance, can be used by all members of the board of directors.

HOW THE GUIDE IS ORGANIZED

The guide is divided into seven parts, each focusing on a separate area of importance to directors. The parts are:

Part I — The Board's Legal Obligations and Board Organization

Part II — Responsibilities of the Audit, Loan, Personnel, and Investment Committees

Part III — Transactions with Insiders and Affiliates

Part IV — Asset/Liability Management and Related Issues

Part V — Financial Analysis

Part VI — Regulatory Oversight

Part VII — Strategic Planning

Part VIII — Other Issues

The chapters discuss the following:

Part I — The Board's Legal Obligations and Board Organization

- Chapters 1 and 2 provide background information on a bank director's legal obligations and board organization. These chapters outline a bank director's basic responsibilities and describe typical board committees. They also highlight the expectations of the bank regulatory agencies.

Part II — Responsibilities of the Audit, Loan, Personnel, and Investment Committees

- Chapter 3, “Audit Committee,” concentrates on the significant part of any audit committee’s job — which involves dealing with the internal audit process, and discusses audit committee membership qualifications, FDIC policies, and the committee’s duties and responsibilities. There also is a discussion about audits and examinations to help board members determine which type of audit or examination may be best suited for their bank. The section on selecting an auditor focuses on practical considerations for the audit committee to follow during the auditor selection process. Criteria for an effective internal audit program and for evaluating internal audit effectiveness are also provided.
- Chapter 3A, “Sarbanes-Oxley Act and the Audit Committee” addresses the board of directors’ responsibility for the oversight of the institution’s internal audit function and the appointment of the external audit firm. These functions have taken on new meaning subsequent to the Sarbanes-Oxley Act of 2002 (SOX). This chapter describes the changes that are being driven by SOX to keep the Audit Committee members informed about new responsibilities for corporate management, internal and external auditors, and board members.
- Chapter 3B, “Improving the Quality of Financial Reporting,” describes the PCAOB responsibilities for managing the integrity of the external audit process and details how the quality of financial reporting may be improved. A summary and analysis of recommendations for improving that quality is also presented.
- Chapter 3C, “Financial Statement Disclosures,” examines several factors to consider when deciding issues about disclosure of material events. You must determine i) whether a particular item of information should be disclosed, and, if so, ii) where such a disclosure should appear on the financial report. This chapter is restricted to these two issues regarding disclosure.
- Chapter 4, “Loan Committee,” discusses loan committee membership qualifications and the committee’s duties and responsibilities and presents a framework for a loan policy by outlining the minimum areas that you should cover. The chapter also describes the types of reports that the loan committee should receive monthly for monitoring credit quality. Basic information on Community Reinvestment Act (CRA) requirements is also included to help the committee understand your bank’s regulatory obligation under the CRA.
- Chapter 5, “Personnel Committee,” provides an overview of the typical issues that a personnel committee faces, such as compensation, which includes a discussion of incentive bonuses, health and life insurance, retirement plans, stock options, phantom stock plans, and deferred compensation plans. The chapter details the contents of an employee handbook, which can be used as a basis for a review of your current handbook or the drafting of a new one. Finally, the chapter discusses personnel evaluation and management succession.
- Chapter 6, “Investment Committee,” discusses the investment committee’s duties and responsibilities and many of the regulatory and accounting considerations that enter into the investment management function. It also summarizes in detail the limitations on

investment authority for national banks and the related implications for state banks. Distinctions between securities and loans are described and areas to be covered in an investment policy are listed. A simple investment policy is provided to illustrate how you might review or revise your bank's current policy. Regulatory guidelines for investing in mortgage derivative products and for unsuitable investment practices are summarized, management control considerations, including management reporting and oversight, are discussed, and accounting considerations are summarized.

Part III — Transactions with Insiders and Affiliates

- Chapter 7, “Transactions with Insiders and Affiliates,” deals with that topic — one of the most troublesome and often misunderstood regulatory areas in banking. General considerations for transactions with insiders are described, and detailed information on the restrictions on loans to insiders (Regulation O) and transactions with affiliates (Federal Reserve Act sections 23A and 23B) is provided.

Part IV — Risk Management and Related Issues

- Chapter 8, “Asset/Liability Management,” covers a difficult but basic function of banking. Board responsibilities and regulatory considerations are outlined, a sample asset/liability management policy is provided to illustrate policy considerations, and a discussion of different asset/liability management systems (e.g., gap analysis, simulation analysis, and duration analysis) showing the similarities and differences of each approach and the related strengths and weaknesses is included. The chapter also discusses an approach for selecting asset/liability management software and provides a detailed checklist for software selection.
- Chapter 9, “Setting Up a Nondeposit Investment Sales Program,” advises the board of directors on how to evaluate the risks involved in selling investment products and how to develop policies, procedures, and internal controls to minimize customer confusion or inaccurate representations.
- Chapter 10, “Risk Management,” describes the types of risks common to community banks and related risk management issues. This chapter includes an outline of risk assessment guidelines that were developed by the OCC. The outline can be used as a tool for assessing internal risk.

Part V — Financial Analysis

- Chapter 11, “Financial Analysis,” suggests a format for providing minimum financial information to the board of directors monthly. Key performance ratios are also discussed, together with their implications.

Part VI — Regulatory Oversight

- Chapter 12, “Regulatory Oversight,” discusses CAMEL ratings, capital definitions and requirements, the regulatory examination process, types of regulatory actions, and the

FDIC premium assessment system. The chapter also covers loan ratings used by examiners and dividend considerations.

Part VII — Strategic Planning

- Chapter 13, “Strategic Planning,” discusses the board’s role in developing and implementing a strategic plan for the bank. This chapter includes a discussion of the strategic planning process.

Part VIII — Other Issues

- Chapter 14, “Insurance Coverage,” focuses on the two types of insurance common to most banks — banker’s blanket bond and directors’ and officers’ liability insurance. This chapter is intended to help you understand the coverages and options available under these two types of policies.
- Chapter 15, “Taxation of Banks,” provides a detailed summary of the tax aspects of banks.