

New Bank Director Nitty Gritty

The Role of the Bank Director After Sarbanes-Oxley

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What is a DIRECTOR ?

- **director** (di-rĕk'ter) n.

1. one who gives authoritative guidance to an action or operation, points out the way, prescribes a course, 2. a member of a board of persons who govern the affairs of an institution on behalf of its stockholders.

The Role = Leadership

“The board has been transformed from one of general knowledge and oversight to one of action, detailed knowledge, and independent thought. It is now an initiator of policy rather than just a validator.”

Desire to Learn

Willingness to Question

Why The Role Has Changed

- A Changing Industry
 - Disintermediation

Why The Role Has Changed

- A Changing Industry
 - Disintermediation
 - Technology
 - Service Quality
 - Delivery Systems
 - Legislation
 - The Consuming Public

Why The Role Has Changed

- A Changing Industry
 - Products
 - Profitability

Why The Role Has Changed

- A Changing Industry
 - Products
 - Profitability
 - Employees
 - Terminology
 - Risk
 - Regulatory Environment

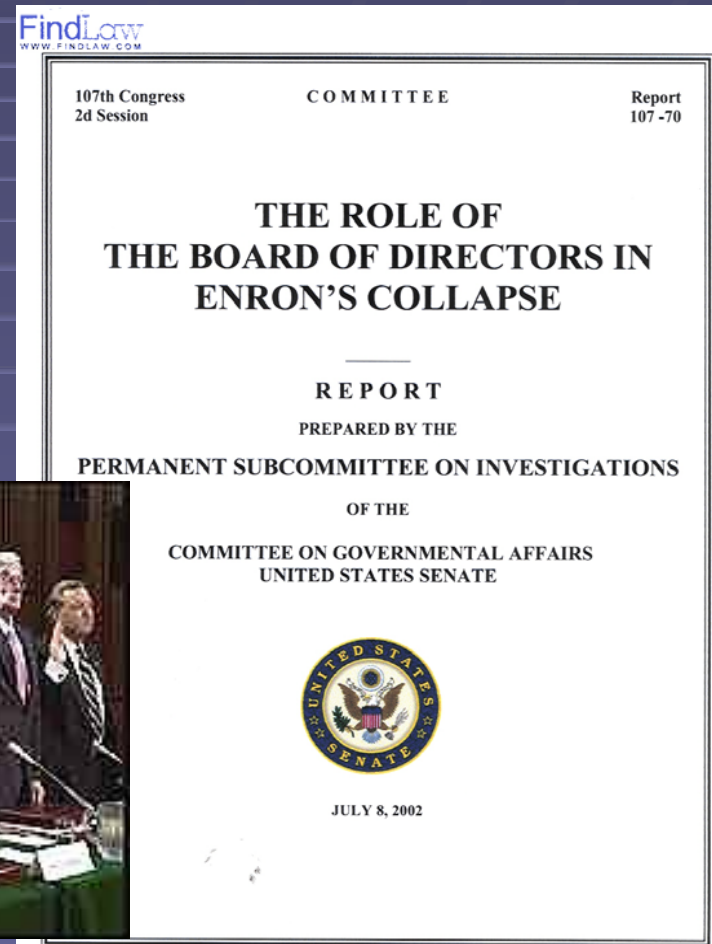
Why The Role Has Changed

- A Changing Industry
 - Products
 - Profitability
 - Employees
 - Terminology
 - Risk
 - Regulatory Environment
- Consolidation & Convergence

Why The Role Has Changed

- Recent Events !!!
 - Enron, Worldcom, Adelphia, Tyco, etc.
 - Root Cause – LACK OF ACCOUNTABILITY
 - CEO to Board
 - Board to Stockholder
 - Lack of effective governance
 - Lack of ethical decision-making

Why The Role Has Changed



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Why The Role Has Changed

- Sarbanes Oxley Act of 2002 - SEC
 - Heightened Scrutiny
 - Regulators
 - Stockholders
 - Public

“Sarbanes Oxley has not really changed the role but the expectation that the role will be fulfilled knowledgeably, independently and diligently and the accountability if it is not.”

Why The Role Has Changed

- Sarbanes Oxley Act 2002 and other major regulatory initiatives mandate new standards of governance.....

INDEPENDENCE

The Current Role

- The Right Level of Involvement

The Current Role

- The Right Level of Involvement
- Strategic Planning
 - Common Vision
 - PROCESS not EVENT
 - Understand the Process
 - Ensure Communication of the Process
 - Monitor the Process

The Current Role

- The Right Level of Involvement
- Strategic Planning
- Policy Making and Limit Setting

POLICY MAKING

- Policies around the strategic objectives.
- All functional and operational areas.
- Take into account Risk/Reward goals.
- NOT STATIC

LIMIT SETTING

- Limits around policies allow control without micro-management.
- Limits provide senior management with authority to get on with the job.
- The board backs off.

The Current Role

- The Right Level of Involvement
- Strategic Planning
- Policy Making & Limit Setting
- Monitoring & Oversight
 - System of CHECKS & BALANCES
 - Oversight of Risk

The Current Role

- Oversight of Risk
 - Credit Risk
 - Interest Rate Risk
 - Liquidity Risk
 - Market Risk
 - Price Risk
 - Strategic Risk
 - Operational Risk
 - Reputation Risk
 - Environmental Risk

Become and Stay Well Informed

QUESTION YOURSELF:

“Do I understand enough about my institution and the industry in general to make informed business decisions in my capacity as a director?”

The Current Role

- The Right Level of Involvement
- Strategic Planning
- Policy Making & Limit Setting
- Monitoring & Oversight
- Become and Stay Well Informed
- Fiduciary Responsibility

STOCKHOLDERS

Goals ?



BOARD OF DIRECTORS



INSTITUTION

Goals:

Profitability

Safety

Soundness



REGULATORS

Motivation ?

Goal Priorities ?



MANAGEMENT

Motivation ?

Goal Priorities ?

Goals and Motivations

Business Strategy	Management Goal	Regulator Goal
Liquidity	Low (For higher profitability)	High (For less risk)
Interest Rate Risk	Higher (For higher profitability)	Low (For less risk)
Capital Ratio	Lower (For higher profitability)	High (For less risk)

The Current Role

- Capital Management
- Director/Management Relationship

The Current Role

- Capital Management
- Director/Management Relationship
- Director/Regulator Relationship
 - Their job gets tougher as the industry evolves
 - They are urged on by overzealous politicians
 - Motivation is different
 - Regulations often imposed as a result of questionable activities
 - They operate on the Best Practices System (Tremendous source of information)

The Current Role

- Capital Management
- Director/Management Relationship
- Director/Regulator Relationship
- Board Policies
 - Regularly evaluate your own policies and your own effectiveness.

The Current Role

- Capital Management
- Director/Management Relationship
- Director/Regulator Relationship
- Board Policies
- Bank Policies & Procedures

The Current Role

- Capital Management
- Director/Management Relationship
- Director/Regulator Relationship
- Board Policies
- Bank Policies & Procedures
- Common Law Legal Responsibilities
 - DUTY OF LOYALTY
 - DUTY OF CARE

Duty of Care

- Regularly attend meetings
- Participate *Actively* and *Knowledgeably*
- Question dubious situations
- Deal with management problems
- Exercise *Sound* and *Independent* business judgment
- *Obtain* and *Understand* all available information before making a business decision

The Skills & Knowledge Required

- Know Your Bank

“Directors who willingly allow others to make major decisions affecting the future of the corporation wholly without supervision or oversight may not defend their lack of knowledge, for that ignorance itself is a breach of fiduciary duty” (Joy vs. North 2nd Circuit 1982)

- Know the Industry

The Skills & Knowledge Required

- Know Your Bank
- Know the Industry
- Economics
- Financial Statement Analysis
- Regulation & Compliance
- Management Concepts

The Skills & Knowledge Required

- Management Concepts
 - Capital Management
 - Risk Management
 - Asset & Liability Management
 - Liquidity Management
 - Asset Quality
 - Profitability and Performance Measurement

CAMELS

- **C** APITAL ADEQUACY
- **A** SSET QUALITY
- **M** ANAGEMENT QUALITY
- **E** ARNINGS HISTORY & FORECAST
- **L** IQUIDITY
- **S** ENSITIVITY (to market risks – IRR, Price Risk, ForEx Risk, etc.)

Summary: What is involved in GOVERNANCE

- Providing Strategic Direction
- Policy Making
- Limit Setting
- Backing-off to let management do the
MANAGING
- Monitoring and Oversight

Summary: What is involved in GOVERNANCE

- Providing Strategic Direction
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MANAGING
- Monitoring and Oversight

- Leadership

Summary: What is involved in GOVERNANCE

COMMON SENSE

+

COMMON LAW

=

COMMON VOICE

LEADERSHIP

“Responsibility is a unique concept: it can only reside in a single individual. You may share it with others, but your portion is not diminished. You may delegate it , but it is still with you. Even if you do not recognize it or admit its presence, you cannot escape it. If responsibility is rightfully yours, no evasion, or ignorance, or passing the blame can shift the burden to someone else.”

Admiral Hyman Rickover, US Navy.

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