

## DIRECTOR DUTIES

By Don Musso, President, and Scott Martorana, Managing Director, FinPro, Inc.

Today's bank boards are more active, educated, informed, and demanding than ever. The time demands placed on board members have also increased dramatically, while Sarbanes Oxley and other corporate governance matters have elevated the risks of being a director. In addition, regulatory and shareholder expectations are ever increasing as is the burden of disclosure. Within this context, here are seven key action items that will help to improve your board.

**Utilize regulatory resources.** All banking agencies have published and issued a significant amount of guidance for directors of insured institutions. At least annually, and as part of ongoing training for directors, the guideline materials produced by your institution's regulator should be mandatory reading for all directors. Some of the better resources include:

- The Pocket Guide for Directors published by the FDIC;
- The Director's Book published by the OCC; and
- The Directors' Responsibilities Guide published by the OTS.

**Promote open communication.** To operate effectively, the board must promote open and honest discussion around the board table. Not all board votes need to be unanimous, and board members should feel comfortable and free to exercise their individual judgment. Open communication mitigates the risk of factions developing within the board. Communication also diminishes the likelihood of an adversarial atmosphere with management. Well-defined information and open communication are key characteristics of successful boards.

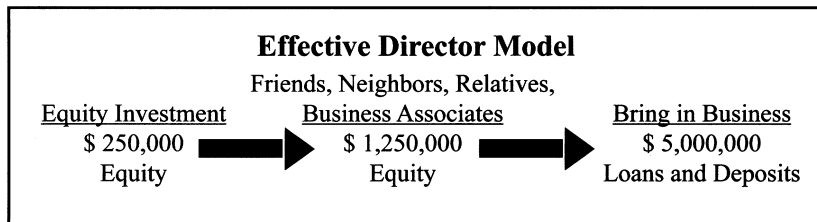
**Provide value.** Successful boards demand that members provide value to the organization. This value could take the form of business development and referrals, expertise such as being a qualified financial expert, time availability (particularly for loan committee), industry contacts, and knowledge or capital generation. Many directors provide value inside the boardroom. However, many bank directors throughout the country often overlook the fact that what they do outside the boardroom can have an even larger impact on the institution. Directors should act as ambassadors for the bank

throughout the community and as a constant source of referrals for business.

**Be active in generating business.** Most de novo banks that are being formed today understand the importance of an active board. It starts before the de novo bank even opens for business. De novo boards are built to provide entry into the dominant local market segments and are composed of local community and business leaders. The most successful de novos have compiled a well connected group of market centric organizers and directors that can generate substantial business referrals. The key to relationship banking is to get leaders from the targeted segment on either the board or in management. FinPro recommends that your directors:

- Own significant equity in the bank;
- Generate equity capital from friends, neighbors, relatives, and business associates (typically 5 times their own investment); and
- Generate loans, deposits, and other business referrals to the bank regularly.

This level of contribution from each organizer and director will ensure that a de novo bank gets to critical mass quickly or that an established institution continues to grow. An effective board is the equivalent of a brick and mortar branch without the expense.



**Get good information.** Management needs to make the board's job easier. Good decisions begin with good information. Concise, timely, and accurate

reports help boards perform their fiduciary responsibilities. The board has to have access to reports that enable them to identify deviations from bank plans and policies, industry and peer trends, and regulatory requirements. Regulators, with their increased emphasis on risk management in their examination and supervisory activities, are focusing on banks' mechanisms and reporting to identify, measure, monitor, and control risk. Board members are expected to know and understand the institution's financials. Directors should read, interpret, and analyze issues prior to meeting and ar-



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rive prepared to have an intelligent discussion. The only way for this to happen is for board packages to be received in advance of meetings.

**Manage Fiduciary Risk.** To minimize risk, boards should consider implementing these three strategies:

- On a quarterly basis, have one external board member select three to five random lines on the regulatory CALL or TFR report and ask management to show you how the numbers were derived and what sources were utilized. In addition, select three to five random general ledger numbers and ask management to provide you with the account reconciliation.
- Change each loan write-up to include a positive assertion that the loan being presented is in full compliance with board policy and all regulations and have the loan officer initial the assertion. Provide a detailed rationale for any exceptions.
- Request the board package be amended to include any relevant new sections that aren't already included. One new section would list all key regulatory and fiduciary risk ratios such as loans to borrower limits, legal lending limits, and required capital ratios. Another section would detail the banks stated goals and illustrate actual performance compared to goals. A third section would discuss the Bank Secrecy Act and be inclusive of all bank actions taken relevant to BSA. A final new section would provide a brief synopsis of prioritized risks, which today would include issues such as executive compensation, commercial real estate concentrations, and data and information security.

**Conduct a self assessment.** Just as the board is overseeing management, they should also be policing themselves. The board needs to conduct self-evaluations and analyze individual board members and the collective board to ensure that directors are effective individually and as a whole. In addition to board assessments, issues such as board attendance, business referrals, committee assignments and charters, com-

panywide calendar, and ongoing board training need to be vetted annually. Finally, the board package should be reviewed for adequacy and usefulness of information. Board members should attend a minimum of 75 percent of all meetings in person and "dialing in" should not be a regular occurrence. Just showing up or "dialing in" isn't enough; active participation is vital.

Being a bank director in today's ever changing world requires a dedication to ongoing training and education, which means establishing strong partnerships between boards and management. Re-engineering existing board reports and processes using the seven strategies outlined here can substantially mitigate director liability and reduce time spent on meetings. Successful boards are involved and value driven.

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#### Helpful Hints For Bank Directors

Encourage your directors to:

- Own equity in your institution as this puts shareholder value at the forefront.
- Know your employees, be visible, and visit all of the bank's facilities.
- Know the bank's markets and be visible in the community.
- Obtain ongoing education and training.
- Think independently.
- Avoid personal conflicts of interest.
- Quality experts prior to relying on them and understand their motivation.
- Pay attention to emerging issues such as compensation.