


## **Agenda Topics Being Covered**

- Inform the Board – What the Board needs to know
- Engage the Board – What is the Board's required & desired role in oversight
- Considerations in Board Composition and Succession



## **What the Board Needs to Know**

- Mission of the Board – Corporate Governance
- Fulfilling the Mission – The Board's Key Functions



## The Basics of Corporate Governance

### *Mission of the Board*



- Representation of Shareholders
- Protection of Depositors
- Compliance with Laws, Rules & Regulations
- Community Service



## Representation of Shareholders

### *Duties of Loyalty and Care*

#### Duty of Loyalty

**Common Law standard** – to act with the utmost good faith and demonstrate undivided and unqualified loyalty to the bank.

A bank director must make full disclosures of interests when dealing with the bank.

Observe the rule that the bank's interests must be paramount in any transaction involving a director, officer, employee, or other insider's interest.



## Representation of Shareholders

### *Duties of Loyalty and Care*

#### Duty of Care

**Common Law** – Act in good faith and with diligence in administering bank affairs.



Such good faith and diligence is generally viewed as that which an ordinarily prudent person would exercise.

**Statutory Law** – Many laws require that directors act in a prudent manner or as any prudent business person would in a similar situation.

## Representation of Shareholders

### *Duties of Loyalty and Care*

#### Common Sense Considerations

Be aware of the bank's operating environment



Exercise diligence

Exercise independent judgment

Provide the Board with sufficient data to fulfill duties

## Representation of Shareholders

### *Duties of Loyalty and Care*

#### Business Judgment Rule



**Historical Interpretation** – The business judgment rule is described as a “[...]presumption of] propriety, under certain circumstances, in a Board’s decision.”

“According to the court,”...the rule evolved to give recognition and deference to director’s business expertise when exercising their management power.

If no fraud, illegality or conflict of interest was exhibited, courts resisted reviewing board decisions. Courts were viewed as an inappropriate forum for making business decisions.

**Having a process for investigating facts and making decisions is key.**

## Primary & Foundational Board Duties in Fulfilling its Mission

#### Job #1 – Select/Retain the CEO

- What is the desired profile of the CEO?
- Internal and/or External Candidates?

#### Establish Directives – Risk Appetite, Strategic Direction

- Inform the Board of risks in products, services and delivery channels
- These will help inform desired CEO profile needed

#### Establish Policies to Communicate Risk Appetite and Standards



## Primary & Foundational Board Duties in Fulfilling its Mission (cont'd)

### Monitor Management & Bank Performance

- Inform the Board with timely and accurate periodic reports
- Internal controls help assure accuracy of data reported

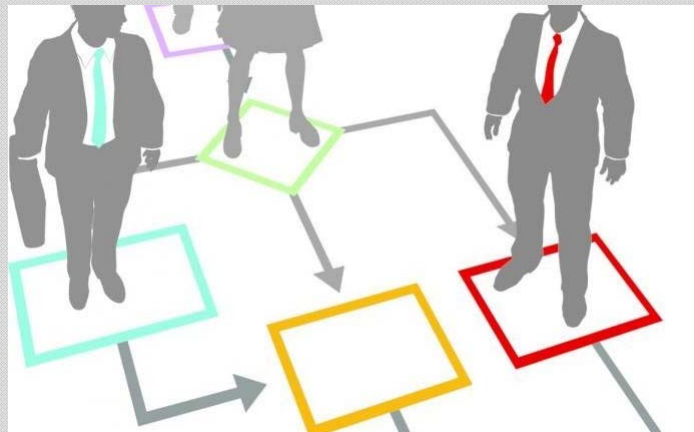
### Exact Discipline and Accountability



### Evaluate CEO's Performance



## Keeping the Board Informed & Engaged



## Board/CEO Relationship

- Trust
- Participation
- Encouragement
- Timely Information
- Opportunity for Discussion



## Board/CEO Relationship






- No surprises
- Input to Agenda
- Value Culture
- Constructive Relationship
- Feedback









## Involve Board in Establishing the Institution's Long & Short Term Goals

### *Understanding & Monitoring the Bank's Risk Profile*

-  Assess the risk in the types of products & services offered
-  Assess risks in how these services are delivered
-  Credit, market, operation, legal, reputational and other risks
-  How does the bank manage/control these risks?
-  Consider internal and external threats to the business model

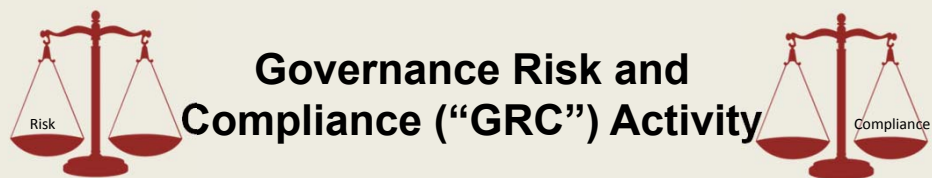


## Setting Risk Objectives and Limits

-  The Board should assist in setting an appropriate risk appetite
-  Risk appetite is the set of objectives and risk parameters within which senior management must operate
-  Focus on risk areas that could affect the **condition** of the bank: credit, concentration, funding, IRR, operational, IT
-  Monitor senior management's adherence and exact accountability as needed







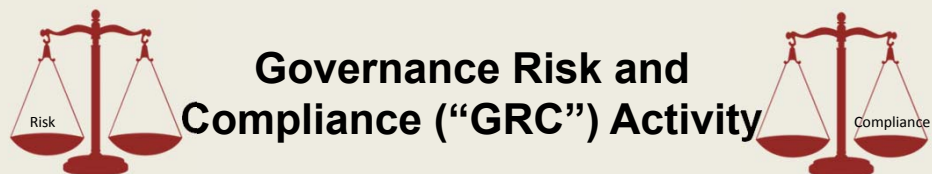
## Governance Risk and Compliance (“GRC”) Activity

### ***Guiding Principles for Board Oversight of Risk\****

#### ***The Board Should Know That...***

1. Risk appetite implicit in the business model, strategy and execution is appropriate
2. Expected risks are commensurate with expected returns
3. Management has implemented a system to manage, monitor, and mitigate risk, and the model is appropriate to your business model and strategy

*\* “Risk Governance: Balancing Risk and Rewards.” National Association of Corporate Directors Blue Ribbon Commission report, January 2009.*



## Governance Risk and Compliance (“GRC”) Activity

### ***Guiding Principles for Board Oversight of Risk (cont’d)***

4. The risk mitigation system informs the Board of the major risks facing the institution
5. An appropriate culture of risk awareness exists throughout the organization
6. There is recognition that management of risk is essential to the successful execution of the company’s strategy

The Bank’s CEO, COO and CFO should be able to inform the Board how they plan to ensure the Board meets these or similar risk oversight expectations.





## Participation in Strategic Planning and Succession Planning

- Strategic plans **guide** the decisions of the Board and senior management
- **What** are the risks in where you want to go?
- Does management have the **skill set**, infrastructure and risk management framework to take the bank where it wants to go?
- **How** does the bank get to where it wants to go?
- Is this **feasible** given the competition and the external environment?



## Monitoring the Bank's Progress in Achieving its Goals



- The most beneficial aspect of strategic planning is the process itself
- Goals and strategies should be clear, measurable, well defined with timelines for achievement
- Changes in internal & external factors can require changes to plan assumptions
- The Board should receive periodic reports on management's progress in implementing the plan
- The Board should ensure the plan is being achieved while staying within operating policies, internal controls, risk parameters and limits



## Current Regulatory Focus...

- While regulatory changes in the 90's reduced the # of failures in this crisis, they did not reduce the impact on the insurance fund.
- Regulators are again **focusing on risk management** and **strategic planning**.
- These are key **Corporate Governance** tenets.




### Why are the regulators pushing Strategic Planning NOW?

One important *lesson we learned* from the financial crisis is that poor planning can harm institutions, their communities, and the financial system as a whole.

Many failures were traced to management engaging in a new or expanded business line *without adequate planning, controls and understanding of the risks* related to the new activity.



- FDIC Supervisory Insights Summer 2015.




Strategic planning is “a **basic responsibility of the Board of Directors**, with assistance of executive officers.”

“Indeed... [strategic planning] is a **key theme running through FDIC guidance** regarding corporate governance and is the **initial step in a sound governance framework**.”

“There is no one right way to conduct strategic planning, but a **prerequisite is a solid understanding by directors and officers of the current operating environment**; the bank’s condition, risk exposure, and business model; and key opportunities and challenges.”

- Summer 2015

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“... supervisory staff **will focus on the adequacy of strategic, capital, and succession planning processes in light of assumed risks and planned initiatives**. Staff will assess whether banks’ plans are realistic and appropriate risk management processes are established and followed.”

“... supervisory staff will assess effectiveness in complying with consumer laws, regulations, and guidance. Staff reviews will include assessments of banks’ processes to analyze, manage, and control risks posed by new products and services and emerging technologies.”

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**Supervisory Insights**  
Devoted to Advancing the Practice of Bank Supervision  
Special Corporate Governance Edition April 2016

**A Community Bank Director's Guide to Corporate Governance:  
21st Century Reflections on the FDIC Pocket Guide for Directors**

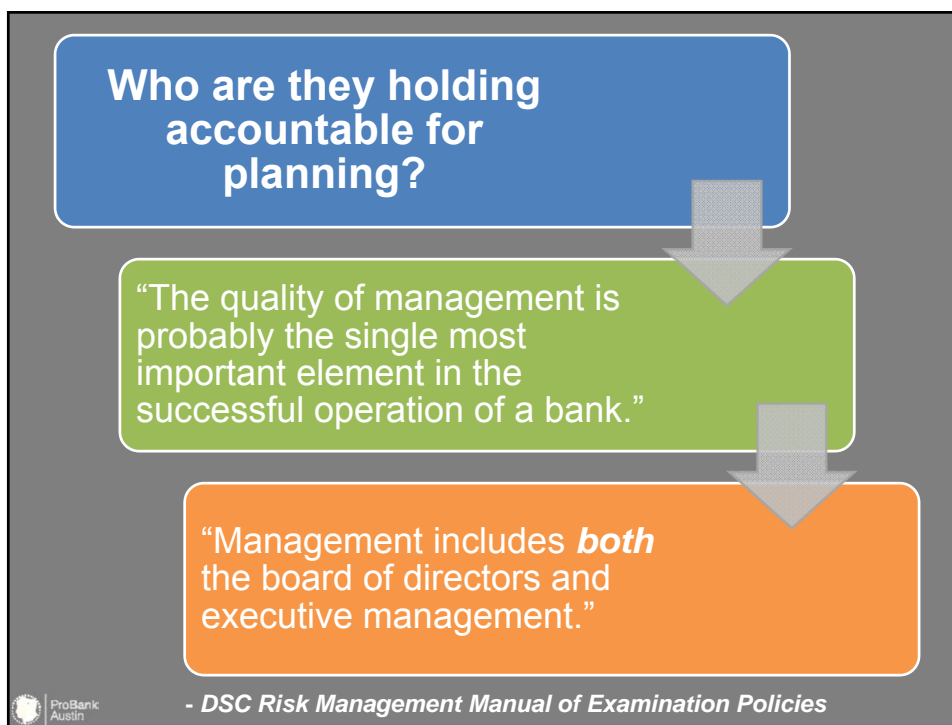
*This Special Corporate Governance Edition for community banks offers commentary on the FDIC's classic Pocket Guide for Directors and other guidance related to corporate governance and **strategic planning**.*

- April 2016

**Inside**  
A Community Bank Director's Guide to Corporate Governance: 21st Century Reflections on the FDIC Pocket Guide for Directors

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## Lessons Learned From the Crisis

*Regulators  
point to  
survivors  
as having:*

- Local Deposit-taking
- Conservative Lending
- Strong Corporate Governance
- Solid Risk Management Frameworks
- Careful Growth Plans
- Well-diversified Balance Sheets



## Community Banking is changing *with continued challenges...*





## Management & Board (and Ownership?) Succession



### FDIC is studying closely held banks

- 58% of closely held banks studied had overlap in ownership & management
- Half of both closely held and widely held banks **had not** identified a viable successor
- Closely held were considered less likely to be able to recruit management talent from outside the bank. *Why?*





**There are a variety of challenges to succession planning for community bankers**



**Geographic Location**



**Business Model**



**Ownership Structure**



**All of the Above**



**WE'RE LOOKING FOR SOMEONE AGE 22-26**

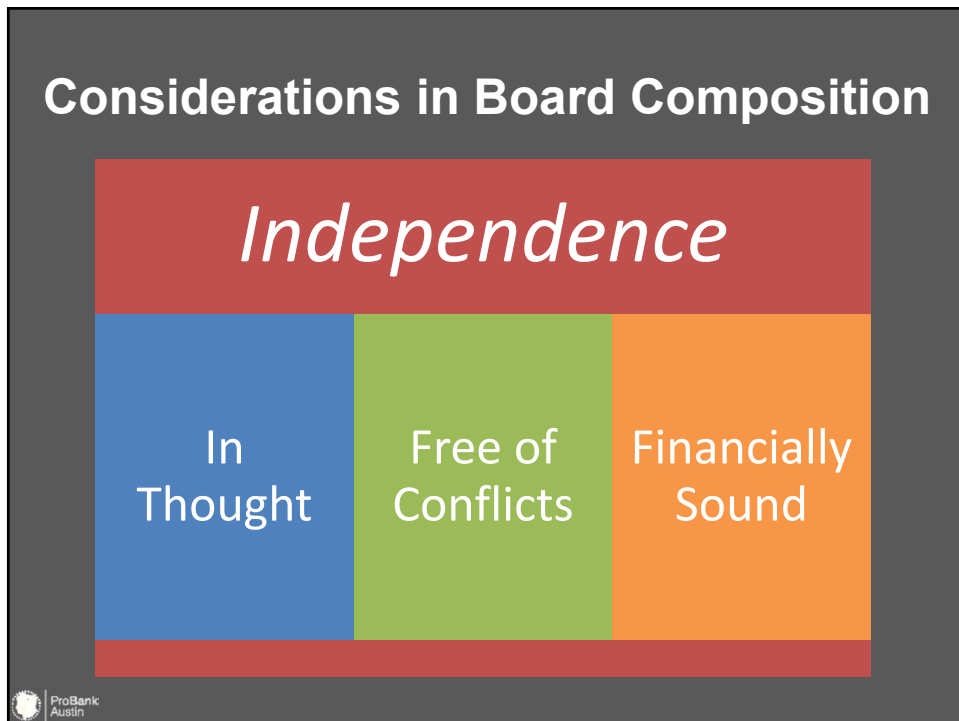
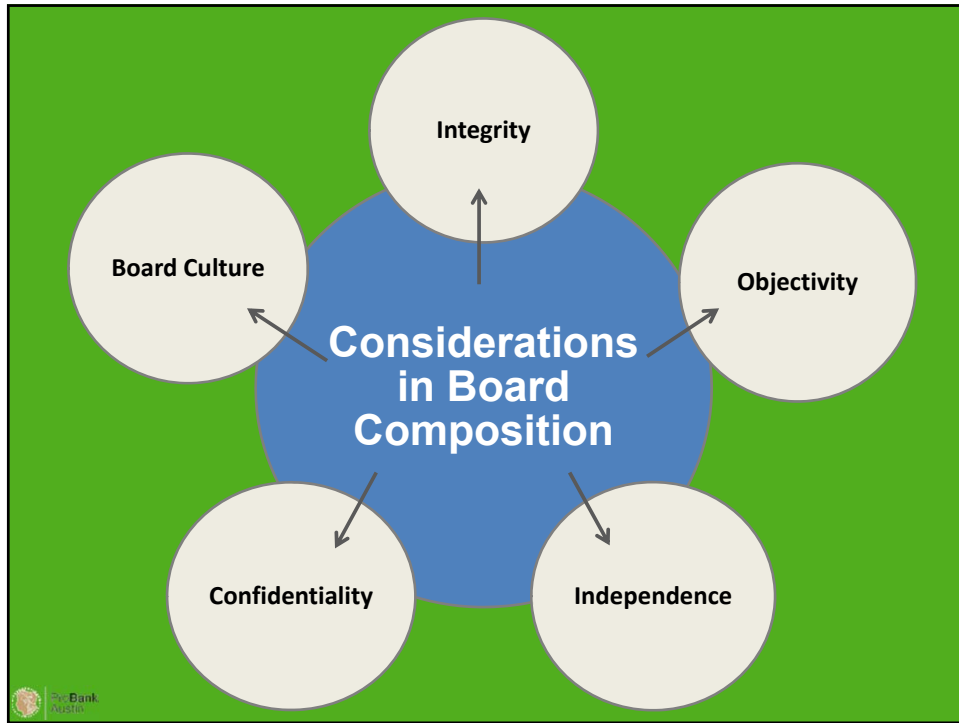


## Key Succession Questions



## Board Succession



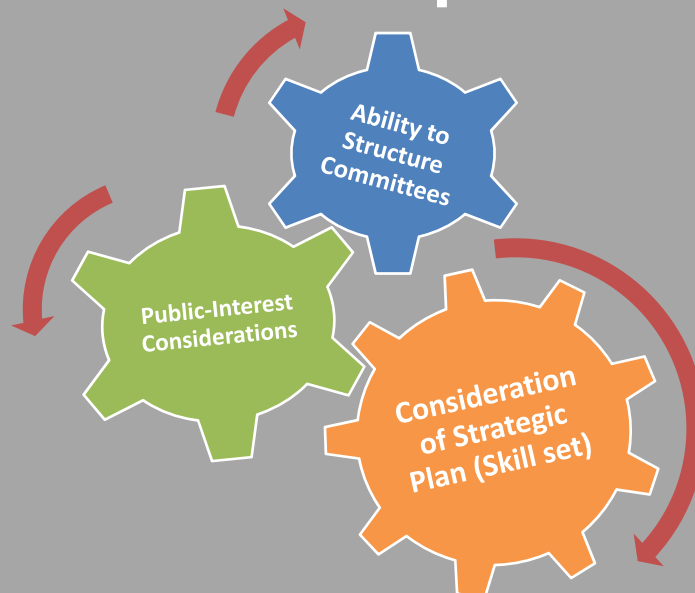


## Board Independence

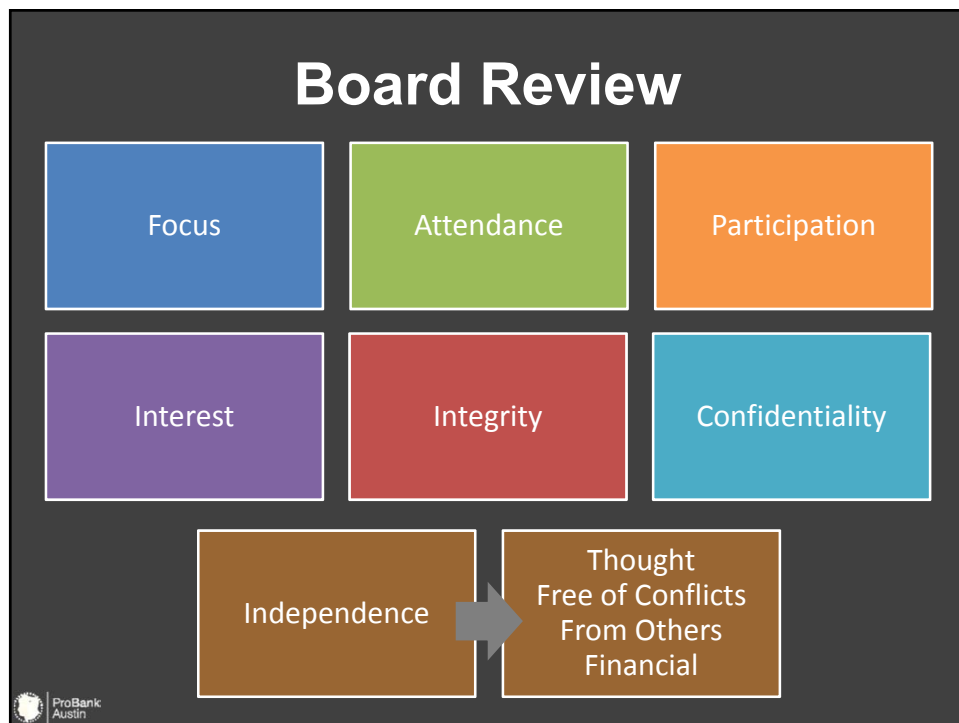
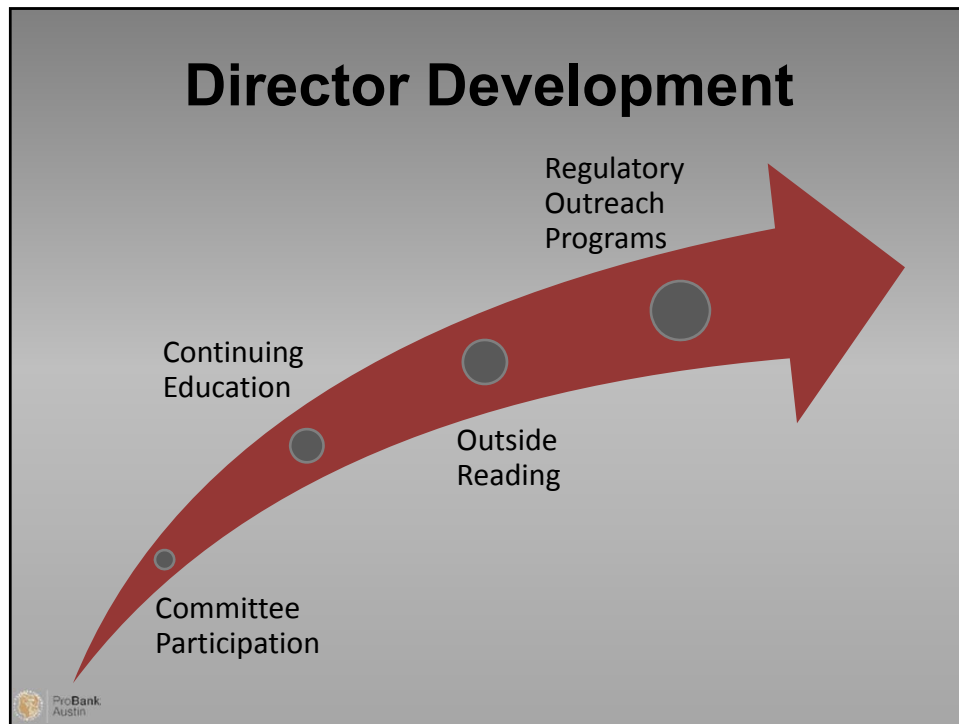


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## Board Composition



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## Key Take-Aways



- Directors play a vital role in risk oversight and must be fully informed and engaged
- The community banking model is changing
- Inform the Board with internal and external data to make key business decisions
- Inform the Board with data to understand and oversee risk in your business model



## Key Take-Aways



- Engage the Board by involving it in risk appetite decisions, strategic planning and succession needs
- Board, management and ownership succession present key risks
- Engage the Board by closely aligning succession planning with strategic planning and risk management
- A strong, informed and engaged Board is a must



# THANK YOU



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