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## **What are the Responsibilities as a Board Member for your Community Bank?**

In the board packet, we hope to cover the following topics for bank boards:

1. What are the responsibilities of the board and some best practices in each of these areas
2. Written policies and procedures (attached).

### **1. What are the basic roles and responsibilities of a Bank Board?**

#### **SET BOARD POLICY AND ELECT NEW MEMBERS**

The structure, for many community banks in Montana, is not ideal. The board members, typically, are made up of retired executives or majority owners of the Bank. Now, although this may not always be wrong, it can be limiting. Bank boards need to start looking at expanding the qualities of their board members to those outside of retired CEOs and majority owners. Bringing in these new fresh faces will also bring in outside perspective and ideas that can revitalize the board.

Some characteristics of good director includes:

- Independence, time to devote to the job, being engaged, resolution, thirst for knowledge and answers
- Careful selection of new board members, keeping in mind the strengths and weaknesses of the other members of the board, is well worth the effort.

#### **Board Age Limits and Term Limits**

Another issue is age and term limits. Although a bank board rarely has term limits as it is difficult to find great board members in small community towns in Montana, it is encouraged to look into the highly debated topic of age limits. With many of the community banks in Montana coming into a difficult timeframe with baby boomers retiring, they are also facing the issue of having an aging board. Many of the board members were the original founders of the bank or at least have been there since the beginning of their career. Although it is not easy to enforce these rules, especially with board members usually having a main ownership percentage, it is a good item to think about for several reasons. Many aging board members have been out of the “banking” business for a longer period of time. With the ever changing environment it is difficult for them to stay on top of the new rules, regulations, and trends. Another item to think about with older board members is whether they are keeping from bringing on new members because they are “holding a place in the board”. If these board members truly are participating and doing a great job for the board, they may really be an asset, but in many cases we have seen where these board members are still attending the meetings, but really are no longer engaged.



### **Policies and Procedures**

The board must ensure that the bank adopts and implements policies and procedures in accordance with proper laws and regulations.

The board must also have a policy that covers their roles and responsibilities. This is usually integrated into what is called an “insider policy”. Included in this packet is a sample of what is typically included in this policy, but all Banks should look to this only as a sample.

### **Re-evaluate the Board Members and Their Roles, Often**

You now have a great board with good potential and have started training and working hard. The key is to make sure you do not lose that momentum. This includes re-evaluation of the board members, their roles, and commitments. The bank board should be ever-evolving and never become stagnant.

## **HIRE THE OFFICERS OF THE BANK**

The Board must hire competent executives such as the Bank president and CEO.

The Board is responsible for the hiring competent officers that are experts in their field that are responsible for the day-to-day activities of the Bank.

## **MANAGEMENT OF THE BANK**

The Bank's board must be capable of managing the Bank in a reasonable manner. As previously stated, the Board is not meant to micro-manage, but they are responsible for the overall well-being of the bank and cannot rely solely on the executives of the Bank.

## **AUDIT/EXAM RESPONSIBILITY**

The Board of Directors is responsible (usually through recommendations by the audit committee) to hire the firm that perform the banks year end audit or other compliance exams or consulting. The board must be informed of all discrepancies found through audits, compliance reviews, and regulatory examinations. They must ensure that all findings are corrected.

### **Know how to help the Bank with Regulatory Exams**

I wish I could say that members of the board *should* be involved in the regulatory examination process, but in today’s environment, the board *must* be involved with regulatory exams. Many board members will be specifically interviewed by examiners and the board’s knowledge, training, and actions will be held under a microscope. Being prepared through upfront training and demonstrating that the board meetings are meaningful, can go a long way with examiners.



## **CONFLICTS OF INTEREST**

Bank board members are not permitted to engage in activities that would be considered a conflict of interest. Board members must also disclose any conflicts of interest based upon their outside business and determine if there are ever any votes that they would have to recuse themselves from. All loans to board members must be reported to the banking authorities.

## **MONTHLY BOARD MEETINGS AND REPORTS**

The board must review all committee reports, including the reports of financial condition on a monthly basis. The board should meet on a monthly basis to review, discuss, and approve the reports generated by bank management.

### **Set an Appropriate Agenda at Every Meeting**

On most boards, the agenda is typically the same from meeting to meeting, which has no real content. When this happens, board members start going through the motions and really stop participating or feeling like they are truly accomplishing anything. You need to take the time to review, revise and update your board agenda before every meeting to make them worthwhile.

Board packages should be delivered well in advance of each meeting in order to provide the directors with adequate time to prepare. Committee chairs should be prepared to give concise but informative reports at the meeting that are on the appropriate level based upon the board members.

### **Board Participation is Critical**

The most concerning board is where there is really only one person in control and making decisions and the rest are coasting and approving that member's ideas. There needs to be, instead, an atmosphere in the board room which allows for constructive criticism and thoughtful interaction encouraging board members to ask the tough questions.

### **Education is Key**

Once a member is elected to the board, this is not only where they display their current education and skill set, but should also be the beginning of their board training and education process. Constant training is key in any profession. Regulators have really started cracking down on boards who lack any formal training or do not pursue education. A good practice is to have a training schedule for board members similar to the expected education you assign to the employees at the Bank.

### **Provide the Board with Beneficial Information, Not just Data and Statistics**

Think to the hot topic out there of interest rate risk (IRR). For years, bank boards have been receiving reports on IRR and how many do you think actually understood (or even read) the pages and pages of documents they received? Probably a small percentage. Why?



There are a couple of possibilities but the most likely one is due to the information they are receiving. IRR is very complicated topic and needs a lot of explaining, but even after all of that, if you give a board members 20 pages of charts, graphs, and data and not real “information” to explain it, do you really think they will read it, let alone understand it? Probably not.

What needs to happen is the information given to the board needs to be given in a summary form that is explainable and readable to all members of the board.

***Conclusion***

Although there is a lot of information in this document, there is still a lot more to go with it when it comes to the responsibility of the Board of Directors. Board members are a critical part in a successful Bank and making sure you have the right people on board and in the right roles can help ensure your success.

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**Director**

Each member of the Community Bank XYZ Board of Directors.

**Executive Officer**

Each person who participates or has authority to participate in the major policy-making functions of the Bank or any company that controls the Bank (if there is one), or any other subsidiary of that controlling company. The Board of Directors, by adopted resolution, has identified the officers/positions listed in Exhibit I as the only executive officers of Community Bank XYZ.

**Principal Shareholder**

Define as applicable for you community bank.

**Related Interest**

Any business entity that an insider is an officer or director of (You can also add more detail of how this ownership was determined – if it is a percentage ownership – usually over 10%), or any business entity in which the insider owns, controls, or has the power to vote (Typically 25 percent of any class of voting securities) or controls the election of a majority of directors or has the power to exercise controlling influence over the policies or management. (The main item typically missed here is “control”) It also includes any political or campaign organization controlled by, or that benefits, an insider. Additionally, for executive officers, the term includes any partnership that the executive officer is a member of and of which the executive officer, or all executive officers of Community Bank XYZ in the aggregate, own 50 percent or more (making them a majority owner).

**Insider**

Each executive officer, director, principal shareholder, and each of his or her related interests. This also includes the same categories of persons for all affiliated organizations.

**REGULATION O AND RELATED LAWS AND REGULATIONS**

The best items to put here are to refer to the regulation that apply specifically to your bank and how they are reviewed by the board members (i.e. annually).

**BOARD OF DIRECTORS RESPONSIBILITIES AND DISCLOSURES**

It is the policy of Community Bank XYZ to avoid the existence or appearance of conflicts of interest and breaches of fiduciary duty by insiders of the Bank.

The Board of Directors of the Bank is charged with protecting the Bank from conflicts of interest. Therefore, detailed disclosure of insiders’ activities with the Bank shall be made to the Board on the following (The below are the basic ideas to be reported on that should be detailed out according to each specific bank’s rules for these transactions.):

- a. Actual or potential conflict of interest regarding insiders.
- b. Any insiders’ related interests.



- c. Insiders' transactions with the Bank. (If payments are made to any board members, the way these are approved and paid, should be described here along with what is considered reasonable. It should indicate these are done substantially the same as they would be to non-related party vendors.)
- d. Terms of loans, transactions, and deposits to insiders.
- e. Excessive fees or terms, (you can possibly discuss what that action would/could be if these were discovered).
- f. Use of facilities.
- g. Arm's length transactions.
- h. By regulation if a loan to an insider and their related interests exceeds in aggregate \$500,000, the extension of credit must be approved in advance by a majority of the Board.
- i. The Bank will make no loan to any insider or related interest that exceeds the aggregate lending limit of the Bank.
- j. Extension of credit by the Bank to an Executive Officer.
- k. Rules for overdrafts of board members.
- l. Record keeping of insider transactions.

The Bank should establish a system to administer and monitor compliance with this policy. This system will ensure that all directors, officers, principal shareholders, and employees are trained, kept aware of, and provided with advice and assistance in dealing with insider issues.

## **RISK MANAGEMENT**

We would recommend a separate risk management policy that this policy references to.

As the below are procedures, some Banks will include them with their policy as written and others will keep them separate as "guidelines" only. These are just some suggested procedures or documentation guidelines for Regulation O and following procedures for board members and executives

## **PROCEDURES (AND DOCUMENTATION)**

1. Maintain a record of every loan granted by the Bank to each insider of Community Bank XYZ and any of its affiliates. For each loan, this record shall include the original amount and terms, the current unpaid balance, the purpose, the collateral, if any, and the aggregate amount of all loans to each insider.
2. Obtain a record of each request from any insider who wants to borrow money from Community Bank XYZ a fully completed loan application on the Bank's forms, together with a current, complete, accurate financial statement when appropriate.



3. Underwrite all insider loan applications using criteria for credit worthiness and nonpayment risk that are no less stringent than those applicable to comparable transactions by the Bank with persons who are not insiders of the Bank. Additionally, set terms of any loan to an insider, including interest rates, collateral, and repayment terms, that are no more favorable to the insider than those prevailing at the time for comparable transactions by the Bank with persons who are not insiders of the Bank.
4. All loans to insiders and their related interests will be submitted to the Bank's Board of Directors for approval. Any loan that would raise the aggregate of all loans to the insider and his or her related interest above \$500,000 shall be submitted to the bank's Board of Directors for approval prior to the loan being made (as noted in the above policy).
5. Document all loans to insiders in the same manner as comparable loans to persons who are not insiders of the Bank; and follow 12 CFR 215.5 of Regulation O.
6. Present to the Board of Directors at each meeting a list of all loans to insiders that have been made by the Bank since the last board meeting.
7. Prepare at the end of each calendar quarter, a list of the names of all executive officers, principal shareholders, and their related interests who have aggregate extensions of credit from the Bank equal to or greater \$500,000. You must provide the list to anyone who makes a written request for it and keep a record of every request and how it was handled. You must retain these records for at least two years.
8. Any insider of Community Bank XYZ or any of its affiliates who wants to obtain credit in any manner from the Bank shall complete an application on the Bank's standard forms and deliver it to the Bank/Branch President (or other assigned personnel), together with a current, complete, accurate financial statement.
9. No executive officer or director of Community Bank XYZ or any of its affiliates shall create an overdraft on his/her checking account in an amount greater than the available balance of his/her overdraft credit line. Unless the overdraft is inadvertent, aggregating \$1,000 or less, and remaining outstanding for less than five days. The insider will be charged the same fee charged for any other customer of the Bank in similar circumstances.
10. Each executive officer, director, and principal shareholder of Community Bank XYZ and any of its affiliates shall provide the Compliance Officer (or other appropriately assigned personnel) a list of the companies in which he, she, or it owns, controls, or has the power to vote 10 percent or more of any class of voting securities. This list must be provided annually. For each company, the party shall state whether he or she is an executive officer or director of such company. They must also list any political or campaign committee that he/she controls or benefits from. Each executive officer shall also report each partnership of which he/she is a partner and his/her percentage of ownership interest in each partnership.