

New York Region Directors' and Trustees' College 2023

Navigating the Future
with Lessons Learned



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Objectives

- Discuss the elements of an effective corporate governance framework
- Discuss common bank failure contributors with a focus on dominant officials, fraud and insider abuse, and asset and liability concentrations
- Share specific examples of warning signs and failed bank cases

Bank Failures – Common Contributors

- Poor CRE and ADC underwriting
- Rapid Asset Growth
- Greater use of wholesale funding and nontraditional funding sources
- Lower capital levels relative to risk
- Dominant official(s)
- Fraud or insider abuse
- Failure to manage Asset and Liability concentration risk

Corporate Governance Framework Elements



Effective Corporate Governance

- Profitability
- Competitiveness
- Resiliency through challenging economic and market conditions
- Protecting customers from consumer harm

Dominant Official Definition

An individual, family, shareholder, or group of persons with close business dealings, or otherwise acting in concert that appears to exert an ***influential level*** of control or policymaking authority, *regardless* of whether the individual or any other members of the family or group have an executive officer title or receive any compensation from the bank.

Dominant Official – Risks

- Incapacitation or loss of the dominant official (key person risk).
- Difficulties in detecting and resolving mismanagement, should it occur.
- Inadequate Board planning, training, hiring, organizational and succession policies.
- Absence of clearly defined authorities and lack of definition of the responsibilities that accompany the authorities.
- CEO may control internal and outside auditors.

Dominant Official – Warning Signs

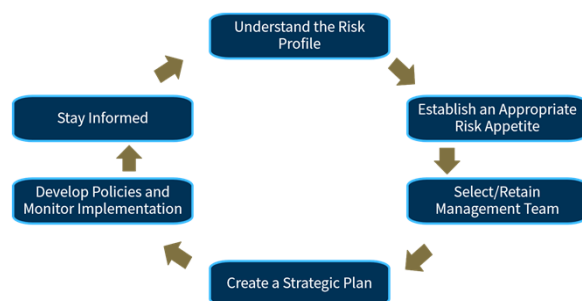
- Dominates policies, procedure, practices, and controls
- Excessive lending authority with no accountability
- Inappropriate Audit Committee influence
- Delayed/missing external audits or frequently changes provider
- Earnings focused without regard for how achieved
- Restricted information flow to Board, Officers, Employees, or Examiners
- Excess computer user access employed at any or odd times

Dominant Official – Examples

- Valley Bank, Moline, Illinois
- Capital City Bank & Trust Company, Atlanta, Georgia
- First NBC Bank, New Orleans, Louisiana

Dominant Official – Link to Corporate Governance

- Maintain Independence
- Keep Informed
- Supervise Management



Fraud or Insider Abuse

- Corporate Culture and Ethics
- Insider Transactions
- Loan Officers

Fraud or Insider Abuse – Risks and Warning Signs

Corporate Culture and Ethics

- Absence of a code of ethics
- Absence of a clear policy restricting or requiring disclosure of conflicts of interest
- Lack of oversight by the board, particularly outside directors
- Absence of planning, training, hiring, and organizational policies
- Lack of independence of management in acting on recommended corrections
- CEO controls internal and outside auditors
- Lax control and review of expense accounts

Fraud or Insider Abuse – Risks and Warning Signs

Insider Transactions

- High debt service without known repayment capacity
- Auditor or legal counsel changes
- Business interests doing business with the bank
- Examiner interaction
- “Perks”

Fraud or Insider Abuse – Risks and Warning Signs

Loan Officers

- Compensation based on loan volume generated
- Inordinately loyal customers
- Consistently high # producer but not large \$
- Undisclosed side businesses with customers
- No reported credit losses or classified loans
- Poor or liberal system access controls
- Controls everything from inception to completion
- High lending authority without accountability
- Takes loan papers out of the bank for signature
- Personally handles all disbursements & payments
- Transactions not properly documented or approved
- Numerous Policy Exceptions

Fraud or Insider Abuse – Examples

- Washington Federal Bank for Savings, Chicago, Illinois
- Connecticut Bank of Commerce, Stamford, Connecticut

Fraud or Insider Abuse – Link to Corporate Governance

Internal Controls

A sound internal control system ensures:

- Accurate financial records
- Prevents fraud
- Safeguards bank assets
- Protects customer information and data



Concentrations – Risks

Asset Concentrations

An institution's asset quality, earnings, or capital can be disproportionately affected by a single or localized economic event or market conditions if the institution holds significant asset concentrations.

Liability Concentrations

The primary risk of a funding concentration is that an institution may have to replace the related funds quickly and/or at unfavorable terms or both.

Concentrations – Example

- Cape Fear Bank, Wilmington, North Carolina



Concentrations – Link to Corporate Governance

- Strategic and Capital Planning
- Develop Policies and Monitor Implementation
- Stay Informed and Provide Effective Challenge



Resources

- [Supervisory Insights, Special Corporate Governance Edition, Revised October 2018 - A Community Bank Director's Guide to Corporate Governance](#)
- [FDIC Pocket Directors Guide](#)
- [Banker Resource Center – Corporate Governance website](#)
- [FDIC Manual of Examination Policies, Section 4.2- Internal Routines and Controls](#)
- [FDIC Manual of Examination Policies, Section 9.1- Bank Fraud and Insider Abuse](#)

Questions

