Office of Thrift Supervision
Department of the Treasury

Directors Responsibilities Guide

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Introduction

The savings association board of directors oversees management activities and is ultimately responsible for the affairs of the thrift. As a director, your responsibilities derive from the duties of care and loyalty and you must execute them with reasonable diligence. Your duty to oversee the conduct of the institution s business requires that you and your fellow directors exercise independent judgment in evaluating management s actions and competence. While you may rely upon advisors and counsel for advice, you must not abdicate responsibility for deciding policy.

Guide

This guide is an overview of core responsibilities, not a complete set of guidelines for savings association directors. As a fiduciary with the public trust of federally insured deposits, you, in your role as a director, are governed by a complex framework of federal and state laws and regulations. This guide does not modify the legal framework in any way, nor does it cover every conceivable situation that may confront a savings association. Rather, it only offers general assistance to meet your responsibilities. Underlying these guidelines is the assumption that you are making an honest effort to deal fairly with the association, to comply with all applicable laws and regulations, and to follow sound practices. You should seek additional information about your responsibilities and consult with legal counsel or other advisors as the need arises.

To make informed decisions, you must have accurate and timely information regarding your association s performance and its compliance with regulatory requirements. The Office of Thrift Supervision (OTS) has prepared this guide and other publications to help you. We encourage you to review this guide and the Thrift Activities Regulatory Handbook

Section 310, Oversight by the Board of Directors. Trade organizations also provide helpful literature, conferences, and other resources to assist association directors and employees. We list some resources at the end of this publication. We encourage you to call upon or schedule a visit with OTS regional office staff if you have questions concerning your duties or responsibilities ■

Responsibilities

You face special challenges because insured banks and thrifts differ from other corporations. Federal deposit insurance subjects a depository institution to special scrutiny and control because of the nature of the business risks and the importance of a safe and sound banking system to the nation s economy. Generating profits with depositors funds creates risks and requires limits on risks that an association can prudently undertake. Your responsibility as a director is to oversee how management operates the association. You must operate the institution safely and soundly and you must make certain that the association provides for the credit needs of its surrounding community or communities, and meets its responsibilities under the Community Reinvestment Act.

Maintain Independence From Management

Effective service as a director requires you to exercise judgment independent of management. Although you work closely with management, you have a different role than managers. You and your fellow directors have overall responsibility for the association s profitability, safety and soundness, and compliance with laws and regulations. To meet these responsibilities, you must establish policies, evaluate performance, and retain top executives.

Management, in turn, runs the day-to-day operations, implements the board s policies, reports on performance, and recommends improvements when possible. Management knowledge and skills are among the association s most valuable assets. However, you must avoid blindly following management s recommendations. You should thoroughly discuss, independently evaluate, and fully understand significant issues and events. Associations whose directors abdicated their leadership responsibility and lost their independence have suffered problems ranging from unimpressive financial performance to fraud, insolvency, and failure. You also face personal liability if you have not acted as a reasonably prudent director would act in similar circumstances.

Although a board of directors does not guarantee the association s success, you must oversee its operations to ensure the association operates with safety and soundness. You must keep informed about the association s operating environment, hire and retain competent management, and ensure that the association has risk management controls suitable for its size and activities. You must also oversee the association s business performance.

The long-term health of a depository institution depends on a board that is independent, knowledgeable, and actively involved in the association s affairs. An effective board contributes by setting tone and direction. It oversees and supports management efforts, testing and probing management s recommendations before approving them. It ensures that adequate internal control systems are in place to identify and address problems before they become major concerns. An effective board is able to evaluate problems, take necessary corrective actions, and, when necessary, keep the association from deteriorating until problems are solved.

You and your fellow directors oversee management and are ultimately responsible for the success of the association. You must take appropriate actions to maximize strengths and to correct deficiencies discovered by the association s staff, regulators, or independent auditors.

Act as a Fiduciary

As a fiduciary, you must think and act independently and in the best interests of the association. When acting in an official capacity, your personal interests and those of your family and associates must be subordinate to the best interests of the association. You should evaluate issues in terms of the association s resources and capabilities, the reasonableness of risk and returns, and any potential adverse effects on the association. You must give particular attention to any activities that might benefit an affiliate or insider. When deciding such matters, you should act not in self-interest or the interests of other board members but for the association. You may not advance your personal or business interests, or those of others, at the expense of the association. You must disclose to your fellow directors all material information relevant to the board s decision, and refrain from participating in the board s discussion and from voting on any issues with a potential conflict of interest. At all times, decisions and actions must comply with applicable laws and regulations. You have fiduciary duties of care, loyalty and candor to your association. These duties must override your obligations as a director of a holding company or other affiliate. To be reasonably prudent, you must be aware of your responsibilities, keep well informed, be attentive to risk, and participate in committees ■

Be Aware of Your Responsibilities

Business demands and legal standards that govern an association s board require you to serve with dedication and vigilance. We cannot overemphasize that you may delegate assignments, **but may never delegate your responsibilities as a director**. While we encourage you to use board committees, you must understand that you are still responsible for the course of action you take and the decisions you make. As a director, you should be aware of principal areas of board responsibility:

Select and Retain Competent Management

The most important factor in the success of an association is the quality of its management. It is rare that the cause of a serious problem or the failure of an institution is other than mismanagement. Most association failures are the result of inattentive, inadequate, or dishonest managers. You must stay keenly aware of management s activities. Your early detection of managerial problems can mean the difference between success and failure of the association.

Meeting periodically, the board makes major decisions about the association s business goals, policies and procedures. Management, in turn, translates the board decisions into day-to-day business activities. You and your fellow directors can fulfill your responsibilities only with the help of a skilled and trustworthy management team.

Establish the Association s Objectives and Strategies

Business objectives are the overall priorities of the association, such as increasing shareholder value or earnings, reducing costs, enhancing efficiencies, and meeting community credit needs. You may think of objectives as general orders governing the association and its employees. Besides being a map for future operations, objectives provide a basis to establish measurements of performance. Comparing actual results with stated objectives is one method to judge the appropriateness of the association s operating strategies and the effectiveness of its management. To compare actual results with stated objectives, the board must have objectives that are specific, chronological, realistic, and written. Objectives and implementing strategies should be part of every association s business plan.

The business plan is a detailed forecast of the association s principal operations and financial results for the next one to three years. A budget that identifies the resources necessary to meet the stated objectives should support the business plan. It should allocate resources to attain the objectives listed in the plan.

Identify and Understand the Risks Presented by Your Objectives and Strategies

All business ventures require a knowledge and understanding of the risks involved in following various strategies to meet objectives. A business must identify and understand risks if it is to limit and manage them. Some risks of particular importance to savings associations are interest-rate risk, credit risk, technology risk, and liquidity risk. These risks have profound effects on the value of assets and the costs of liabilities, and thus, the viability of the association.

Establish Policies and Procedures to Attain Your Objectives

The board must develop policies and procedures guiding principles and broad courses of action that will help the association attain its objectives. Specific operating policies are necessary to govern key business activities. At a minimum your association s policies should address:

- lending,
- investments,
- capital planning,
- internal controls,
- valuation allowances,
- asset quality and credit risk management,
- asset/liability and interest-rate risk management,
- off-balance-sheet activities,
- human resources and benefits,
- business planning and budgeting,
- internal and external audit programs,
- a code of ethics to reduce conflicts of interest,

- compliance with safety and soundness, consumer protection, nondiscrimination, and other public policy, statutes and regulations (including the Community Reinvestment Act)
- disaster recovery and contingency planning (including employee safety and security)
- computer information services (including technical hazards)
- the privacy and accuracy of customer personal information.

The board should review the policies and procedures at least once a year to consider what changes are appropriate.

Monitor and Assess the Progress of Operations

Once management, objectives, strategies, policies and procedures are in place, the board should establish an ongoing review of the association s performance. You should compare current operating results with business objectives, the results of previous periods, recognized standards, peer group and industry performance, and the results of periodic reports by independent auditors and regulators. You must read and understand management reports, ask questions to further your understanding, and in some cases obtain third party validation that the reports are prepared under acceptable policies and procedures.

Internal reports generally will include information such as the following:

- the income and expenses of the thrift,
- capital outlays and adequacy,
- loans and investments made,
- past due and renegotiated loans and investments,
- problem loans, their present status and workout programs,
- allowance for probable and estimable loan losses,
- concentrations of credit,
- losses and recoveries on disposition of assets,
- funding activities and the management of interest rate risk,

- performance in all of the above areas compared to past performance as well as to peer group performance,
- all insider transactions that benefit, directly or indirectly, controlling shareholders, directors, officers, other employees, or their related interests,
- activities undertaken to ensure compliance with applicable laws (including lending limits, consumer requirements, the Community Reinvestment Act, and the Bank Secrecy Act) and any significant compliance problems,
- any extraordinary development likely to impact the integrity, safety, or profitability of the thrift.

The board must require a system of internal controls. It must monitor compliance through several means, including board committees, internal audit reports, specific internal control functions, independent audit reports, auditors management letters, and regulatory reports and correspondence. The board should promptly consider and act upon information from these sources, including promptly taking appropriate corrective actions to correct deficiencies. In addition, the board may seek appropriate advice from independent consultants or outside counsel at the expense of the association. Enforcing compliance with required standards may involve passive measures such as reviewing internal audit reports, or active measures, such as correcting or dismissing managers who repeatedly or flagrantly violate important guidelines.

Ensure that the Association is in Compliance with Laws and Regulations

As a board member, you are responsible for ensuring the association complies with the various laws and regulations governing its operations. These include lending limits, safety and soundness, consumer protection and nondiscrimination. To help meet this responsibility, you should consider having management provide summaries of basic legal requirements and regular reports on compliance, and ensure that staff have adequate training.

Conduct Your Affairs Ethically and Avoid the Appearance of Conflicts of Interest

The institution should not engage in preferential transactions with insiders. This includes transactions with directors, executive officers, principal shareholders and related interests. Transactions with insiders must be beyond reproach. They must be in full compliance with laws and regulations concerning such transactions, and be judged with the same objective criteria used for transactions with other customers. You must document the basis of such decisions to avoid serious personal civil and criminal liability.

Ensure that the Association is Meeting the Needs of its Community

Under the Community Reinvestment Act, you are responsible for ensuring that your association meets the credit needs of the communities where it operates, including low- and moderate-income areas and borrowers. In doing so, you will be supporting the community that supports the association. Adherence to fair lending laws is a major factor in Community Reinvestment Act evaluation. If a thrift is illegally discriminating, it cannot be effectively serving its communities. You must ensure that appropriate fair lending policies, procedures, and controls are in place at your association ■

Be Well-Informed

Primary responsibility for the association s safety and soundness lies with you, your fellow directors, and management not with government regulators. Remember that the board is ultimately responsible for the safety and soundness and profitability of the association. There are a number of things that you should do to keep well informed, including:

- prepare in advance for board meetings;
- require a complete and consistent board information package be distributed in advance of meetings;
- require complete and accurate minutes of all board meetings;
- keep up to date with news about the association, the financial services industry, and the general business climate of the association s communities;
- review and heed regulatory examination reports and all supervisory correspondence;
- discuss key issues with senior management both in and out of board meetings; and

- review and respond to reports from internal and external auditors and board committees.

Information should flow to the board from four primary sources: management reports, internal audit reports, external audit reports, and examinations. These reports should provide you with a broad perspective. You should watch for significant inconsistencies among these sources and obtain a satisfactory explanation for any major discrepancies. Additionally, watch for trends and new developments noted in these sources and follow up as needed.

Management is responsible for providing monthly, quarterly, annual, and special reports to the board. You should receive and review these reports before regular meetings. Management should clearly present its views and recommendations. The board must objectively review and analyze management s recommendations and provide appropriate responses. Although some boards only meet quarterly, we recommend monthly meetings. More frequent meetings divide directors work into more sessions and enable more prompt responses to problems.

Periodically, management and the board should carefully review the makeup of the board report package to ensure that the information is concise, complete, timely and useful. Reports should present only relevant information without unnecessary detail. Too much detail can hide potential risks that are more visible in summaries. Your board may delegate details to committees for further study with recommendations brought to the full board for action.

Although reports evolve and improve over time, report formats should remain comparable from period to period. Consistency improves the effectiveness of a report as an oversight tool. Management can use frequent changes to mask serious problems. You may prefer to see some material presented graphically to show performance trends.

The principal point of contact between an association s directors and the OTS comes during the examination. Examinations are part of continuous monitoring and regulatory supervision. The periodic safety and soundness examination assesses the financial health of an association. The periodic compliance examination assesses compliance with consumer-related laws and regulations, including the Community Reinvestment Act and fair lending laws. A chief purpose of either examination is to alert you to issues or problems that may not have come to your attention and to suggest solutions. The OTS makes the examination a useful tool for management and the board. We recommend that you use the examination to learn as much as possible about the condition of your association and its prospects.

Counsel must give legal advice pertaining to the savings association directly to decision makers whose interests do not conflict with those of the thrift. The association s counsel owes a duty of loyalty to the association, not to the directors and management, who in some cases may be the controlling owners. For example, to provide adequate representation and advice, the association should obtain separate counsel to negotiate employment agreements and director benefits. In addition, you should not use the association s legal counsel to mediate disputes with other directors. You should retain your own counsel for personal purposes ■

Be Attentive to Risk

The OTS recognizes that associations must assess and assume carefully calculated risks to be profitable. Your association must establish an adequate system to manage those risks for its size and complexity of operations. You must be aware of the various risks confronting your association, the magnitude of those risks, and management s ability to limit risk-taking to an acceptable level consistent with the board strategy. The board and management must work together to ensure that they adequately identify, measure, monitor, and control risks.

Risk management is a continuing, active process involving the whole organization. Larger associations may want to establish a separate, independent risk management function. Smaller or less complex associations can accomplish this objective through active management and board oversight ■

The Usefulness of Committees

You may find it difficult to deal with the increasing volume and complexity of the information you receive. You may find it useful to establish committees of the board with special expertise to understand and interpret complicated data. Each committee should include directors with appropriate expertise as well as a mix of outside directors and management. The risk of a committee controlled by inside directors (management, former management, principal shareholders, and relatives), is that it may filter information provided to the other board members to present management in the most favorable light. Regulations of the Federal Deposit Insurance Corporation require all insured institutions with year-end assets over $500 million to have an audit committee composed of outside directors who are independent of management. This ensures that the internal audit function is independent of management. Committees should report regularly to the full board. The full board is ultimately responsible for its, and each board committee s, decisions. The board must assure itself that the committee acted responsibly and its recommendations are reasonable.

Some common committees are the Executive, Strategic Planning, Loan, Audit, Examination, Investment, Asset/Liability Interest Rate Risk, Information Technology, Compensation and Personnel, Compliance, and Community Reinvestment Act (CRA) and Fair Lending committees. The board may also establish ad hoc committees to deal with particularly significant current issues such as Year 2000 technology problems. We describe the four most important committees here.

The executive committee generally acts with authorization in the board s absence between board meetings, with actions usually subject to board ratification or prior blanket approval. The executive committee can perform more detailed reviews of information and operations, and coordinate the work of the other committees.

The strategic planning committee considers the environment in which the association operates, including the law, the economy and competition. It decides how best to address them in choosing and achieving long-range goals. The committee considers plans and strategy in the broadest sense and recommends a plan to the board with benchmarks for measuring progress.

The loan committee reviews lending policies and monitors management compliance with policies. The loan committee reviews the adequacy of the valuation allowances for loan and lease losses.

The audit committee monitors management and staff compliance with board policies, laws, and regulations. The audit committee supervises the internal and external audit functions. An audit committee should include members with thrift or related financial experience who are not employees or customers of the association to ensure judgment and observation independent of association management. An association with significant transactions with affiliates needs to ensure that its audit committee membership also is independent from its affiliates.

Members must document the proceedings of each meeting of the board and the committees. At each meeting of a board or committee, members must approve the minutes of the previous meeting. They record approval in the current minutes as a record that members agree that the previous minutes are accurate.

Success as a director requires perseverance, intelligence, and commitment. It is not easy work. If you can combine independent business judgment with attention to important detail you will contribute substantially to the success of your association. Directors do not require extensive training or background knowledge. Excellent thrift directors have come from very diverse backgrounds, including a variety of businesses and professions. An association s prosperity benefits not only shareholders (or mutual account holders) but also its customers and community. Board membership thus offers the opportunity for public service in its broadest sense, and OTS applauds you who accept that opportunity ■

Core Principles for Directors

ATTEND WELL PREPARED

1 Attend board meetings well prepared.

THINK INDEPENDENTLY

2 Think independently of management and evaluate proposals from management and others carefully.

INSIST PROPOSALS MAKE SENSE

3 Insist that proposals that do not make sense be clarified, modified, or rejected.

TAKE PERSONAL RESPONSIBILITY

4 Take personal responsibility for the safety, soundness, and profitability of the association, and the laws and regulations that protect its customers and the surrounding community.

DISCLOSE CONFLICTS OF INTEREST

5 Disclose any personal interests and those of your family and associates that may be, or appear to be, a potential conflict with the interests of the association, and refrain from acting on those transactions.

We encourage you to routinely access the OTS website, at http://www.ots.treas.gov, or contact your OTS regional office for more information and background materials.

The following is a list of available references that contain information of general interest to directors:

AICPA Audit & Accounting Guide, Banks and Savings Institutions, Revised Edition, American Institute of Certified Public Accountants, 1996. Phone: (212) 596-6200, Internet: http://www.aicpa.org.

The Audit Committee Handbook, America s Community Bankers, 1995. Phone: (202) 857-3100 Fax: (202) 659-1134, Internet: http://www.acbankers.org.

The Banker s Resource Book, (catalog), American Bankers Association, 1996. Phone: (800) 338-0626, Internet: http://www.aba.com.

The Board Member s Manual, A Guide for Financial Institution Directors, America s Community Bankers, 1995. Phone: (202) 857-3100 Fax: (202) 659-1134, Internet: http://www.acbankers.org.

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