Comptroller of the Currency
Administrator of National Banks

A Web and Telephone Seminar

Corporate Governance and the Community Bank: A Regulatory Perspective

Tuesday, August 2, 2005
and again on
Wednesday, August 3, 2005

Speaker Biographies
PowerPoint Presentation

Julie L. Williams

Acting Comptroller of the Currency

Office of the Comptroller of the Currerncy

Julie L. Williams became Acting Comptroller on October 14, 2004, succeeding John D. Hawke, Jr. at the end of his term of office. Ms. Williams was initially appointed Chief Counsel of the Office of the Comptroller of the Currency in June 1994, with responsibility for all of the agency's legal activities, including legal advisory services to banks and examiners, enforcement and compliance activities, litigation, legislative initiatives, and regulation of securities and corporate practices of national banks. As the agency's statutory "First Deputy," she previously served as Acting Comptroller from April 6, 1998 through December 8, 1998, before Mr. Hawke was sworn in as the 28th Comptroller of the Currency.

As Chief Counsel, Ms. Williams also supervised the Licensing Department and the Community Affairs Department, and served as a member of the OCC's Executive Committee. In her current position, Ms. Williams leads the Executive Committee in providing policy and strategic direction to the agency.

Ms. Williams joined the OCC in May 1993 as Deputy Chief Counsel with responsibility for special legislative and regulatory projects. Before joining the OCC, Ms. Williams served in a variety of positions at the Office of Thrift Supervision and its predecessor agency, the Federal Home Loan Bank Board, culminating in a position as Senior Deputy Chief Counsel at the OTS from 1991 to 1993. Ms. Williams joined the Bank Board in 1983, after working as an attorney with the law firm of Fried, Frank, Harris, Shriver & Kampelman in Washington, D.C. from 1975 to 1983.

Ms. Williams is the author of *National Banks and the Dual Banking System* (Comptroller of the Currency, 2003) and *Savings Institutions: Mergers, Acquisitions and Conversions* (Law Journal Seminars-Press, 1988), and has published numerous articles on the regulation of depository institutions, financial services, securities and corporate law matters.

She was awarded a B.A. in 1971from Goddard College, Plainfield, Vermont, and a J.D. in 1975 from Antioch School of Law, Washington, D.C., where she was first in her class.

Karen Kwilosz

Director, Operational Risk Policy

Chief National Bank Examiner's Office

Karen Kwilosz was named in 2002 as director for Operational Risk Policy in the Chief National Bank Examiner's Office. Karen oversees the development of regulatory policy for national banks in the areas of corporate governance, audit and controls, payments systems, and supervision by risk.

Karen spent the first half of her OCC career examining banks in the Denver, Colorado area. She transferred to OCC's Washington, D.C. Headquarters office in 1995 and spent seven years managing the training operations division.

Karen is a native of Chicago, Illinois and was graduated from Millikin University in 1982.

Kirk Spurgin

National Bank Examiner and Operational Risk Policy Analyst,
Chief National Bank Examiner's Office

Kirk is an operational risk policy analyst in the Chief National Bank Examiner's office. The Operational Risk Policy division is responsible for developing regulatory policy for national banks in areas such as corporate governance, audit and controls, and supervision by risk. Kirk's primary responsibilities pertain to policy development in the arena of board and management supervision. Kirk is currently working on a new *Comptroller's Handbook* booklet on that topic.

A native of Texas, Kirk spent approximately 10 years as a community bank examiner in various locations in Texas in the 1980s and early 1990s. He then transferred to San Francisco, where he managed the problem bank and examination support divisions. Kirk spent two years in the large banks program in San Francisco before relocating to Washington, D.C., and joining the Operational Risk Policy division in 2001.

Maryann H. Kennedy

Assistant Deputy Comptroller
Wilkes-Barre Field Office
Maryland National Capital Area, Satellite

Maryann Kennedy became in May 2000 the assistant deputy comptroller for the Wilkes-Barre field office of the Office of the Comptroller of the Currency (OCC) and in April 2005 assumed responsibility for the Maryland National Capital Area as a satellite office. Prior to joining the OCC, Maryann worked for eight years in the banking industry in positions within loan review, commercial lending, and consumer lending. Before moving to Wilkes-Barre, she worked for the OCC in both community bank and large bank supervision in the Philadelphia area. Maryann also has experience in the OCC's "mid-size" banks as well as the monoline credit card companies. In this capacity she served for five years on the OCC's Northeastern District Credit Committee.

She was graduated from Ohio State University.

OCC Web & Telephone Seminar

Corporate Governance and the Community Bank: A Regulatory Perspective

Office of the Comptroller of the Currency
August 2-3, 2005

Today's Focus

Community bank boards of directors can strengthen corporate governance by

- Assessing "tone at the top"
- Establishing an effective relationship with the CEO and management
- Focusing on risk management

Governance Fundamentals

- Governance is not new
- Focus on underlying principles and not "check the boxes"
- Yes–it's hard work
- It's really all about the people

Actions Boards Can Take

Assess the corporate culture and “tone at the top”

Culture and “Tone at the Top”

Characterized by:

- Strictly enforced code of ethics
- Lack of conflicts of interest
- Open and candid communications
- Clear lines of authority and responsibility
- Transparency of policies and practices
- Strong internal controls and audit function
- Whistle-blower process

“Tone at the Top”

Other actions boards can take to improve the tone at the top:

Evaluate your own skills and competencies.

Examine your relationship with the CEO and senior management.

Assess the appropriateness of board and committee operations and processes.

Skills and Competencies

- Financial literacy
- Knowledge of banking industry
- Willingness to devote sufficient time
- Sound judgment, objectivity, inquiring mind
- Knowledge of community
- Diverse business backgrounds
- *Personal integrity*

Board Independence

- Lacks significant relationships with the bank and management
- Directors are not beholden to or heavily influenced by CEO, another director, or principal shareholder
- Consider personal and social relationships
- Directors must direct and not be led
- *Bottom line:* Should be an appropriate mix of independent and management directors to promote arm's-length oversight and shareholder advocacy

Board Operations and Processes

Consider developing guidelines on:

- Director qualification standards
- Director responsibilities
- Director compensation
- Director continuing education
- Management succession
- Director access to management and independent advisors
- Performance evaluation of the board

Four Basic Board Types

- Negative Impact
- Neutral/No Impact
- Basic Monitor/Checklist
- Performance Enhancer

The “Negative Impact” Board

- Risk-averse
- May micro-manage
- Unprepared for meetings
- Pays little attention to the proceedings
- Poor decision-making processes
- Adversarial
- Panics in crisis situations

The “Neutral/No Impact” Board

- Rubber-stamps management’s initiatives and recommendations
- Fails to do its homework or prepare for board meetings
- Avoids conflict and constructive engagement
- Does not hold the management team accountable
- Out of touch with business risks
- Feels a sense of entitlement

The “Basic Monitoring” Board

- Very structured and regimented
- Good at basic governance processes of reviewing, approving, and monitoring
- Driven by process rather than principle
- “Check the box” mentality
- May have lost sight of strategic direction

The “Performance Enhancer” Board

- Knows and understands the bank’s business and competition
- Focuses on strategic issues and risk management
- Supports governance best practices
- Establishes high, realistic standards of performance

The "Performance Enhancer" Board
(continued)

- Enhances decision-making by rigorous analysis
- Attracts and retains top management team
- Empowers and holds CEO accountable
- Links CEO compensation to shareholder value

Four Basic Board Types

- Negative Impact
- Neutral/No Impact
- Basic Monitor/Checklist
- Performance Enhancer

What kind are you?

Actions Boards Can Take

Defining the line between management and board oversight

Corporate Governance Continuum

Defining strategic direction

Approve Policies

Day-to-day execution

Test and Verify

Adjust as Needed

What is YOUR Role?

- Establish a clear direction
- Select good people to follow this direction
- Actively oversee
  - Challenge, ask questions, hold management accountable
  - Measure performance against expectations
  - Fire managers who don’t measure up to your standards

Board’s Role: Establish a Clear Direction

- Develop and approve a strategic plan
- Establish specific, measurable goals
- Set risk tolerances
- Provide a framework for policies
- Communication

Board's Role: People

- Select competent management
- Open communication
- Hold management accountable
- Measure management's performance in relation to compensation
- Dispense with officers who prove unable to meet reasonable expectations

Executive Compensation

- Compensation hasn't been an issue with community banks
- Avoid incentive plans that could encourage manipulation of short-term financial performance to the detriment of long-term shareholder value
- Examiners will be looking more closely at compensation going forward

Board's Role: Oversight

- Board receives appropriate management information
- Measure, test, and verify: audit
- Adjust as needed

Management's Role

Primary Role: Implement board's strategy, risk tolerances, and policies

- Keep directors fully informed
- Day-to-day operations and staff
- Policy exception tracking
- Management information systems

Board and Management – Roles

"Line in the Sand"

- NIFO – Nose In Fingers Out
- Board of directors leads
- Managers manage
- Open and honest communication

Actions Boards Can Take

Actively oversee the risk management function

Overseeing Risk Management

- Need to regularly “tune-up” the risk management program
- Do it now, before problems emerge
- Management’s job is to implement your guidance – your job is to make sure they are following your guidance
- You need to make sure your guidance is still appropriate for bank’s environment

Five Steps to Gauge Effectiveness of Risk Management

1. Educate yourselves
2. Re-evaluate bank’s strategic objectives and risk tolerances
3. Ask candid questions of management
4. Clean up board reports
5. Use board committees for key risk areas

Overseeing the Audit Program

- Audit is cornerstone of the risk management program
- Need to evaluate effectiveness of program as a whole – the same as you need to do with the overall risk management program

Evaluating the Audit Function
Four Steps to Take

1. Self-assessment of the audit committee (or full board, if no audit committee)
2. Get educated – to oversee audit, board needs to have financial literacy
3. Evaluate internal control program (backbone of the audit function)
4. Meet with audit and internal control staff

Parting Thoughts

As a group, your bank's board should answer these three questions:

1. What "tone" have you set at the top? Does it permeate the whole bank?
2. How do you engage with your management team? Where is your "line?"
3. How healthy is your risk management program? When did you last check it?