The Responsibility Of Bank Boards

by Steve Brown

There was a period during the financial crisis when we were certain many bank board members wondered what in the world they were thinking when they decided to join the board of a bank. Board members of community banks are most often pillars of the community, business owners and elder statesmen/women of a local area or town. Most bank board members are NOT experts on finance and banking regulations, but they are local business owners, developers, doctors, lawyers, ranchers and represent a host of other professions. As such, most board members probably did not fully comprehend the credit risk building in the industry or on their own bank's balance sheet pre-crisis. Then when things got ugly in a hurry, they found themselves being held responsible for things they may not have fully understood.

In an attempt to address the varying levels of knowledge among board members, the FDIC is making a big effort to increase communication with community banks. Furthermore, the summer 2014 issue of Supervisory Insights featured detailed coverage on the responsibility of bank boards.

The article explores trends in exam findings requiring prompt board attention, those "Matters Requiring Board Attention" (MRBA). The FDIC has tracked MRBAs over the past 4Ys and the results offer insight into the improvement in the health of the banking system overall, as well as bringing to light the migration of regulator focus. MRBAs are primarily found (85% of them) among institutions with a rating of "1" or "2" from the Uniform Financial Institutions Rating System. This almost seems counterintuitive, but this is because lower rated institutions typically are already under either a formal or informal enforcement action that imposes more aggressive requirements.

During the past 4Ys, about 48% of institutions with satisfactory ratings had at least one MRBA, but the percentage of institutions has declined in the past 2Ys reflecting the improved financial conditions in the industry.

Over this time, MRBAs have most often addressed deficiencies in two categories: Loans (about 69% of institutions with MRBAs), and Board/Management (45% of institutions with MRBAs). Overall trends in the numbers indicate a decrease in the number of loan and liquidity related MRBAs, an uptick in interest rate risk, rising IT concerns, Board/Management and Earnings.

Within the broad category of Loans, over 75% of the MRBAs were related to credit administration and focused on the need to improve appraisal review, loan review and the loan grading system. There was also focus on reducing exceptions (loan data or collateral documentation in particular), an increased need for loan cash flow analyses and proper accounting for troubled debt restructurings.

As for the Board/Management category, 49% of the MRBAs here highlighted the need to revise and comply with policies. Audit is included in this category and was the next area of concern with 27% of board-related MRBAs. Recommendations range from the need for development of an audit plan that reflects the institution's risk profile, to the need for increased oversight of the audit function. Other areas requiring attention included strategic planning, succession planning, risk management practices and overall oversight.

It's important for bank management to keep board members informed by sharing reports like this one. Board members know it is their responsibility to look out for the health of their institution, but often those inside the bank are in the best position to help keep them informed. Losing community bank board members is the last thing the FDIC wants. Board members bring business and referrals to the bank, provide capital, bring local knowledge and diversity of expertise. Directors are wiser for having survived the past 5Ys, but along with senior management, they have probably gained a few more grey hairs as well.

BANK NEWS

M&A

Pilgrim Bank ($386mm, TX) will acquire State National Bank of Texas ($240mm, TX) for an undisclosed sum.

Divestiture

CertusBank ($1.6B, SC) said it will sell its mortgage and wealth management business lines for an undisclosed sum to AmeriSave Mortgage and Eximius, respectively, as it seeks to cut costs and transition to more of a traditional community banking business model.

Bankrate Investigation

Reuters reports the CFO of Bankrate has resigned and the company said its financial statements for 2011 to 2013 should not be relied upon, amid an examination by the SEC into improper accounting of accruals and expenses.

Settlement

HSBC said it will pay $550mm to settle claims around mortgage bonds the bank sold to FNMA and FHLMC prior to the financial crisis.

More Loans

In Q2 loan growth finally outstripped deposit growth for the banking industry, increasing $178.5B and 172.5B, respectively.

Rate Hikes

JPMorgan economists project the Fed will start raising rates in mid 2015 and that the rate will be 2.50% by the end of 2016. The bank also predicts FOMC members at the next meeting will show members expect to keep raising rates through 2017, eventually reaching around 3.50% to 3.75%.

Staying Put

A global banking survey of consumers by EY finds 60% of customers do not have definite plans to open or close any accounts in the next 12 months.

Branch Update

HBR reports that in 2013, more U.S. bank branches closed last year than ever before, but about 75% of primary accounts were opened at branches. Meanwhile, 85% of retail banking transactions are now entirely digital.