

Corporate Governance and Oversight by the Board of Directors Program

EXAMINATION OBJECTIVES

To assess whether the composition of the board of directors provides for sufficient breadth and depth of expertise to ensure adequate oversight of the association's affairs.

To determine whether the board of directors fully understands its duties and responsibilities and is discharging its responsibilities appropriately.

To determine whether the board of directors has adopted adequate policies, procedures, and operating strategies (including internal controls, a compliance management program, and audit and loan review procedures) to conduct the association's operations prudently.

To determine the existence of any conflicts of interest or improprieties involving directors.

To determine the extent of compliance with statutory and regulatory requirements applicable to directors of savings associations.

EXAMINATION PROCEDURES

LEVEL I

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1. Review the association's business plan, budgets, and policy statements. Determine if the board of directors establishes objectives and policies for the association in general and for specific relevant areas of operation. Determine whether objectives and policies are compatible with applicable laws, regulations, the charter or articles of incorporation, bylaws, and conditions for insurance of accounts. Evaluate the adequacy of stated policies in providing direction to management.
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2. Review board of director's minutes of regular, special, and committee meetings; consider director attendance at the meetings. Determine whether minutes are complete, the extent of significant changes in direction, activities, or policy for the association, and whether specific changes require modification of the scope of the examination. Update the electronic work papers, if appropriate, with new or revised policies (or reference the policies if not retained). You should inform other examiners of noteworthy information found during the review.

3. Review reports that management prepares for the board. Determine if the information is adequate, accurate, and sufficient to support the board of director's decision making. (Examiners reviewing related areas can perform this procedure.) Confirm that management's reports adequately address financial and operational risks, including technology risks, and compliance performance. Provide copies of useful board reports and other information to the other examiners.

4. Review the Matters Requiring Board Attention and Corrective Actions from the three or four previous ROEs to ensure that the board and management have taken appropriate corrective action where necessary and persistent problems have not recurred.

5. Review and evaluate the composition of the board of directors. Ensure that the association meets the requirements in 12 CFR § 563.33. Obtain answers to the following questions and disseminate information regarding directors' interests to the examination team:
 - Is there always a quorum, that is, a majority of the directors that the association's bylaws prescribe, at board meetings?
 - Do the directors, as a group, have sufficient expertise and experience?

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- Are three or more of the association’s directors members of the same family? Do related directors tend to control board actions?
- Do two or more directors also work as attorneys with the same law firm?
- Could the directors’ affiliations have any adverse effects on the association’s operations and, if so, would a larger board offset the possible adverse effects?
- Is there a concentration of board members and, therefore, a concentration of interests in certain businesses (such as real estate or construction)?

6. Determine whether there were any occurrences of self-dealing or conflicts of interest involving the board of directors.

7. Complete the General Questionnaire, Oversight by the Board of Directors located on the Intranet under Systems/Exam Documents/Programs & Ques.

8. Determine whether the board of directors:

- Delegates sufficient authority to management personnel to promote effective and efficient performance and foster an environment for regulatory compliance, while retaining sufficient control to discharge its responsibilities to stockholders, members, customers, OTS, and other regulatory authorities.
- Is aware of significant regulatory changes enacted during the examination period.
- Actively oversees the association’s operations and adequately monitors its performance.
- Provides direction to management as to the development of an optimal risk/return profile.

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- Receives a status report on and approves the association's compliance with the Interagency Guidelines Establishing Standards for Safeguarding Customer Information, which implement Section 501(b) of the Gramm-Leach-Bliley Act of 1999.
- Provides sufficient resources for implementing its compliance management program given the association's business strategies, operational complexity, and regulatory obligations.
- Is aware of all the association's funds management procedures, including management's financial modeling processes.
- Provides sound funds management direction to management.
- Reviews and takes appropriate corrective actions to address adverse findings or criticisms disclosed in internal and external audit reports, reports of examinations, and internally generated reports, such as internal asset review reports and compliance self-assessment reports.
- Reviews the level and reasonableness of officers' salaries and confirms that they are commensurate with their experience and duties.
- Provides adequate oversight of the personnel department and its policies.
- Reports annually to the shareholders in the required format, if applicable.

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9. Review employment contracts. Be especially alert for contracts with long terms or overly generous provisions. Determine whether the association employs or retains persons closely related to officers and directors. Determine whether such relationships or inappropriate contracts have affected, or could adversely affect, the system of internal control, employee morale, or association performance. Ensure employee contracts meet the requirements of 12 CFR § 563.39.
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10. Interview the managing officer and other key officers, including the chief financial officer and the chief lending officer. Determine whether they keep directors informed of the association's financial position and the potential effect of current economic conditions on the association. Also determine the extent of the directors participation and involvement in resolving current operating problems and establishing long-range objectives and policies.

11. Review Level II procedures and perform those necessary to test, support, and present conclusions derived from performance of Level I procedures.

LEVEL II

12. Obtain answers to the following questions relating to the board of directors:

- Does the board of directors review reports from the executive committee, audit committee, loan committee, other committees of the board, compliance personnel, and outside experts at board meetings?
- Do directors and committee members have the opportunity to review and modify minutes of their meetings before approval?
- Are directors aware of significant regulatory changes enacted during the examination period?
- Has the board appointed a compliance officer?
- Has the board adopted and maintained a comprehensive compliance management program predicated on systems, real-time monitoring, periodic self-assessment, organizational accountability, responsiveness to needed improvements, and effective training (OTS' SMAART Compliance Program Components)?

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- Did management consider the results of prior years' compliance reviews and examination reports when they designed procedures for the current compliance review?
 - Did the audit committee or the board review the results of the most recent compliance audit, compliance reviews, and self-assessment reviews?
 - Are adequate systems of internal control present to detect noncompliance with regulations?
 - Are written responses and plans for corrective action required from management concerning deficiencies noted during the compliance audit, reviews, or self-assessments?
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13. Does the association use agents or other third parties to perform certain marketing, solicitation, and customer service activities related to the association's authorized deposit and loan products and services. If so, consider the following:

- Has the board adopted a program to ensure adequate monitoring, supervision, and control over any agents or third parties and the activities that they perform on behalf of the association?
 - Does the program include a comprehensive training program that provides the agent or third party with in-dept training about the association's products and services, as well as applicable laws and regulations?
 - Does the board and management conduct an annual internal or external audit review of the programs, including a review of the training component?
 - Does management and the board review the program annually?
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14. Did each regular director's meeting during the examination period include a review of financial reports of the association and its affiliates? Also, consider the following:

- Do the minutes reflect directors' questions concerning financial reports along with the appropriate follow-up and resolutions?

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- Did the board review recommendations concerning fiscal operations in examination reports and the board of director's letter from independent accountants?
 - Did the board approve and prepare written responses to recommendations contained in examination reports and the board of director's letter from the independent accountants?
 - Does the board regularly assess or monitor management's compliance with board approved major financial polices?
 - Do the minutes reflect that the directors thoroughly reviewed and approved the association's budget?
 - Does management include comparisons of budgets with actual results in financial reports reviewed at each board meeting?
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15. Did the board establish and do they annually review minimum underwriting standards and guidelines, including a large loan policy? Check the following items:

- Does management establish, and does the board review and approve formal lending limits?
- In conjunction with the budgeting process and formulation of the business plan, has the board reviewed and approved the types and volume of lending planned by management?
- Do the association's lending policies require that higher-risk credit extensions and unusual loans (as specifically defined in the policies) be presented to the board for final approval?
- Do the minutes reflect if the board considered any unusual loans or those exceeding ordinary risk? Do the minutes reflect the board's approval or disapproval?
- Do the minutes reflect that the board, in reviewing higher-risk loans, explored efforts to minimize risk and limit the amount invested?

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- Has the board implemented an effective internal asset review function?
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16. Review the following items:

- Does the board define, in writing, the managing officer's duties and responsibilities?
 - Do the directors generally establish and approve compensation levels and pension plans?
 - Do directors approve promotions and bonuses and document such approvals in the minutes?
 - For bonus plans tied to the association's net income, has the board established controls to prevent management from reporting short-term gains at the expense of long-term profitability?
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17. Review directors' compensation for reasonableness. Consider peer group information and the time directors devote to the association's affairs.

18. Determine if operating committees are active between board meetings, and if the committees subsequently report their actions to the board for ratification.

19. Review the association's bylaws, charter or articles of incorporation, and conditions for insurance of accounts. (Include copies in the electronic work papers.) Determine if written policies and procedures specify the duties and responsibilities of management personnel and the board of directors.

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20. Review and consider the CAMELS and other examination ratings in determining your overall conclusions regarding the oversight by the board of directors.

21. Determine if there is a need to review any association transactions for evidence of self-dealing or conflicts of interest.

22. Ensure that your review meets the Examination Objectives of this Handbook Section. State your findings, conclusions, and recommendations for any necessary corrective measures on the appropriate work papers and report pages.

EXAMINER'S SUMMARY, RECOMMENDATIONS, AND COMMENTS

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