



Bank Directors and Risk Management

2008 NACD Bank Directors Workshop

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THE FEDERAL RESERVE BANK OF RICHMOND

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Disclaimer

- The views and opinions expressed herein are mine and do not necessarily reflect the official opinions of the Federal Reserve System or any other banking regulatory agency.



Agenda

- Interest Rate Risk
- Liquidity Risk
- Compliance Risk
- Bank Holding Companies
 - Governance
 - Leverage
 - Liquidity
- Questions





Interest Rate Risk Management

- What is interest rate risk?
- What guidance is available?
- What are sound risk management practices?
- What will examiners assess?
- Common examination findings



Sound Risk Management Practices

- Board oversight
 - Establish tolerances for IRR
 - Policies, risk limits, authorities, responsibilities for managing the risk, adequate resources, process for handling exceptions
 - Monitor the level of IRR, and ensure that this level is prudent/appropriate
- Management responsibilities
 - Develop procedures that implement the board's goals/objectives/strategies and limits
 - Ensure board directives regarding measuring, managing and reporting risks are followed. Report exposures to the board.
 - Oversee implementation and maintenance of MIS used to measure, monitor and control IRR
 - Ensure appropriate internal controls exist and that periodic independent reviews/back testing are conducted





What Examiners Assess

- Adequacy and effectiveness of IRR management process
- The level of interest rate risk exposure
- IRR impact on capital levels
- Whether corrective actions are needed



Common Findings

- Level of risk being taken is too great given the quality of the risk management process
- Specific risk management issues:
 - Policy does not match practice
 - Limits have not been established or are overly broad
 - Policy exceptions not reported to or properly considered by the board
 - Board and committee documentation is often lacking
 - Major model assumptions are not realistic
 - No independent review of the models used, no back testing of results to plan, or the person performing the review is not qualified





Liquidity Risk Management

- What is liquidity risk?
- What guidance is available?
- What are sound risk management practices?
- What will examiners assess?
- Common examination findings





Sound Risk Management Practices

- Board oversight
 - Establish tolerances for liquidity risk
 - Policies, risk limits, authorities, responsibilities for managing the risk, adequate resources, process for handling exceptions
 - Monitor the level of this risk, and ensure that this level is prudent/appropriate
 - Particular attention should be paid to having a robust contingency funding plan
- Management responsibilities
 - Develop procedures that implement the board's goals/objectives/strategies and limits. Measures should go beyond just static ratios – cash flow
 - Ensure board directives regarding measuring, managing and reporting risks are followed. Report exposures to the board.
 - Oversee implementation and maintenance of MIS used to measure, monitor and control liquidity risk
 - Ensure appropriate internal controls exist





What Examiners Assess

- Adequacy and effectiveness of liquidity risk management process
- The level of exposure
- Whether corrective actions are needed

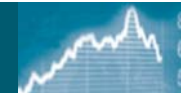




Common Findings

- Policy does not match practice
- Policy does not address the usage of wholesale funds
- Inadequate analysis of the stability of funds
- Limits rely too heavily on static ratios, no proforma cash flow analysis
- Contingency funding plans lack robustness or don't exist
- Policy exceptions not reported to or properly considered by the board
- Board and committee documentation is often lacking
- It's not a bad idea to have your liquidity risk management program reviewed independently – this would be new guidance but it's consistent with IRR expectations.





Compliance Risks – Don't Overlook!

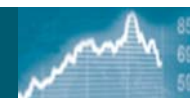
- BSA – has not gone away – still seeing weak risk assessments and suspicious activity monitoring
 - Newer issues trade finance and microstructuring
 - Law enforcement continues to want more data not less
- Consumer compliance/CRA issues – outcomes of subprime crisis – nothing yet
 - Several changes in the works
 - Regulation Z – HOEPA & Truth in Lending
 - RESPA – proposed rules out for comment
- Fair lending reviews are not required by banks; however,can help you avoid a bad consumer compliance rating by being proactive. If discrimination is found this can affect your compliance rating, your CRA rating and possibly lead to formal enforcement
- Be careful as you attempt to tighten credit underwriting that you don't do it in a way that creates a disparate impact





Bank Holding Company Issues

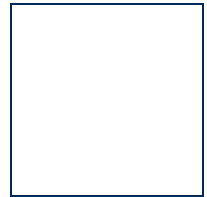
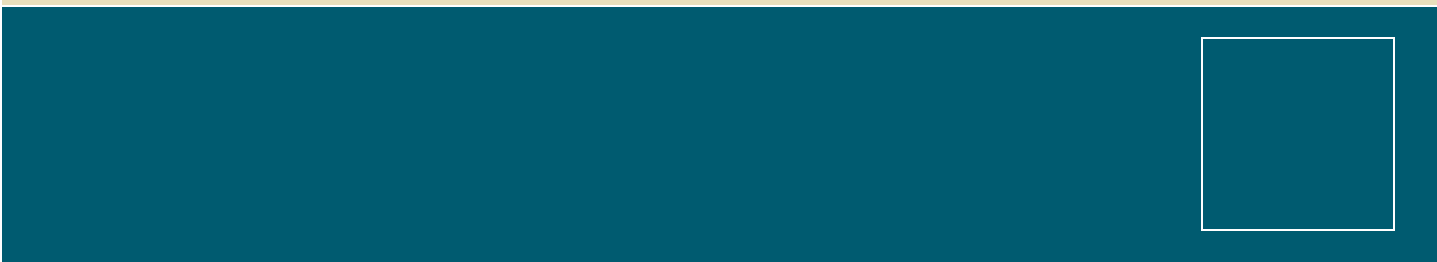
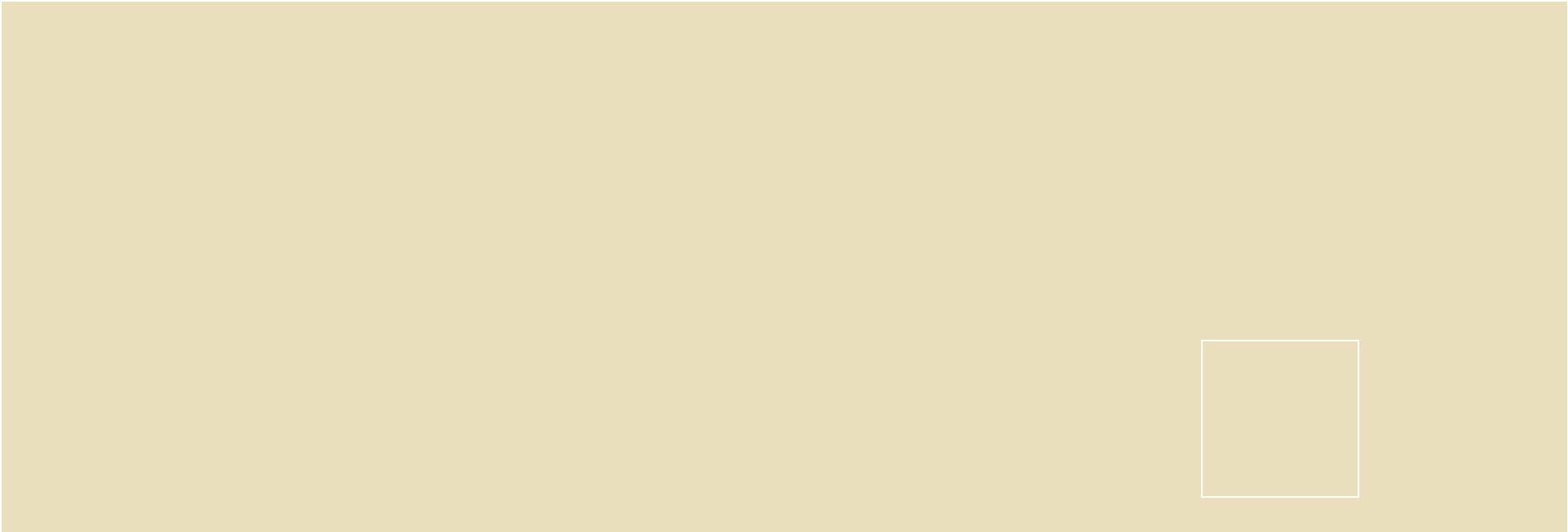
- Governance
- Leverage
- Liquidity
 - Funding policy



Questions



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