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NEBRASKA DEPARTMENT OF BANKING AND FINANCE

Nebraska's State Financial Industry Supervisors since 1890.

Financial Institution Directors: Duties & Responsibilities

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The Financial Institution Directors: Duties and Responsibilities

Foreword

This booklet, compiled by the Nebraska Department of Banking and Finance (Department), is intended to aid members of the board of directors of a financial institution to better understand their duties and responsibilities. Thus the title, *The Financial Institution Directors: Duties and Responsibilities*, was selected to be descriptive of an area that is of the utmost importance to every board member in every financial institution in Nebraska.

The booklet is designed for the newly selected director who often times is appointed without any formal training (although formal training is subsequently required) and learns the job by observation. It is written to help explain and clarify your supervisory duties, assist you in building confidence in your abilities, and to help eliminate confusion. It may also set out a new perspective to the experienced director in establishing a cohesive board and help to build able and active leadership. This booklet is not intended to address all of the issues and responsibilities assumed by a director.

To be an effective director, you must first understand that banks, trust companies, building and loan associations and credit unions are closely regulated. Accordingly, it is important that you understand your financial institution's relationship to government regulations.

Second, you need to understand the relationship that exists between the board and its executive management. The board's role is one of establishing goals and direction (planning) and formulating and monitoring financial institution policies, while management's role is one of implementing such policies. The board manages the Chief Executive Officer (CEO). The CEO should not manage the board.

Third, you need to understand your functions and legal responsibilities. It is important that you perform your duties in a manner that minimizes legal liability to you and your financial institution. Assure that detailed records of the board's decision making process are maintained.

Finally, you need to evaluate the effectiveness of board policies in accomplishing your objectives. Goals need to be established and monitored on an ongoing basis to determine whether the objectives have been reached. Participation with executive management is important in the area of setting goals and objectives. This booklet, however, is not intended to be a legal reference. You should consult your financial institution's legal counsel and your own attorney on matters requiring legal consideration.

The Department has the responsibility to examine your institution to enforce compliance with laws, rules and regulations but it also is instructed by the Legislature to aid and assist your institution in maintaining proper banking standards and efficiency. The Vision of the Department is "To make Nebraska the most trusted financial home for people and businesses" and its Mission is "To preserve the public confidence in the Financial Institutions of Nebraska."

The staff of the Department devotes a considerable amount of time answering questions and providing information. They may be contacted at P.O. Box 95006, Lincoln, NE 68509-5006 or via telephone at (402) 471-2171. Information, regulations, staff contacts, and forms are available on the Department website, www.ndbf.nebraska.gov

The Nebraska Department of Banking and Finance is providing this information as a service. It is neither a legal interpretation nor an indication of a policy position by the Nebraska Department of Banking and Finance. If you have questions concerning the meaning or application of a particular federal or state law or rule or regulation, model rule, statement of policy or other materials, please consult with an attorney who specializes in financial institution law.

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Chapter I

The Director's Role

Chosen to Serve

The Nebraska Legislature has mandated that every member elected to a board of directors be a person of good moral character, with known integrity, business experience and the ability to accept responsibility. Accordingly, it is incumbent upon the financial institution's shareholders to choose people who are respected in the community, capable of serving and willing to lend their good names as assurance to others in the community that the financial institution will be run properly and that all business will be handled in a confidential manner. It has long been considered an honor to be chosen to serve as a member of a financial institution's board of directors, a position which carries important duties and responsibilities.

The Representative

Directors are not only representatives of shareholders, but also, in a sense, representatives of the depositors. Their position is one of a trusteeship, since, unlike other businesses, financial institutions operate not only on stockholders' funds but largely on the funds of depositors. Accordingly, the directors have a special fiduciary relationship to the public and depositors, and special precautions are needed so the directors conduct themselves in a manner that is above reproach.

The One-Member Board

New directors frequently, when first elected, feel dependent upon other members of the board who have accumulated some experience. This is natural because new members sometimes have little or no technical knowledge regarding the financial institutions industry; however, when this feeling becomes deep-seated and widespread, a vacuum exists.

A board cannot be effective if it allows one individual to dominate the functions of the board. This may occur when one member of the board is the principal stockholder (in a stock organization) or a strong willed individual, and other members allow that particular director to dominate all phases of the financial institution's policies and operations. The potential danger inherent in situations of this nature is the lack of input representing various points of view. Informed decision making dictates consideration of many viewpoints, not just those of a majority shareholder or dominant individual. Directors must be prepared to make their views known.

Compensation

Directors are entitled to reasonable compensation for their time and effort unless the articles of incorporation or by-laws provide otherwise. Should members serve on special committees, they might properly receive additional compensation at the discretion of the board. Neb. Rev. Stat. § 21-294 (Cum. Supp. 2016). Officials of credit unions, however, are not entitled to any compensation although they may be reimbursed for expenses incurred while on credit union business, and provided certain insurance coverages. Neb. Rev. Stat. § 21-1761 (Reissue 2012).

Planned Succession of Directors

Succession of management is an important consideration which applies not only to a financial institution's management, but also to members of the board. A financial institution must recognize the need to plan for the retirement of its directors. If the contribution from certain directors steadily diminishes for any reason, this fact must be dealt with. Some financial institutions have met this situation by providing for honorary directors when active involvement is no longer practicable. Such individuals without some mandatory retirement plan, will likely not volunteer to retire, even if management suggests they do. Generally, the honorary director attends board meetings in an advisory capacity without a formal voice or vote in the proceedings.

Directors' Borrowings

Unwarranted extensions of credit to directors of a financial institution in a personal capacity, or to their interests, violates the directors' role of trust. Any loan advanced by a bank to a member of its board or a related interest of that member that is over \$25,000.00 or 5 percent of the bank's unimpaired capital and unimpaired surplus must be specifically approved by the board before any funds are advanced. Neb. Rev. Stat. § 8-143.01 (LB 140 (2017)). Any loan advanced to an official of the credit union, if permitted by its bylaws, must comply with all requirements of the Credit Union Act. The terms of the advance must not be more favorable than those extended to other members. Neb. Rev. Stat. § 21-1796 (Reissue 2012). While there is no express statute relating to borrowings of building and loan directors, the guidelines set forth in the above-cited statutes should certainly apply to building and loan associations.

The financial institution's primary federal regulator (Federal Deposit Insurance Corporation, Federal Reserve Bank, or National Credit Union Administration (NCUA)) has also adopted limits on directors' borrowings. Check those regulations prior to any borrowing, even if the loan is in compliance with state law.

The discussion of the board and its vote on a director's line of credit must be specifically noted in the minutes of that meeting. The borrowing director should not be present during the discussion. Special treatment or preference must not be granted with regard to interest rates, security, payments, or renewals. Inasmuch as directors need to be leading and reputable people in their communities, the fact that they borrow at their own institution is, in and of itself, not objectionable. A position contrary to this would be unfair to the director and would certainly tend to discourage persons having good business judgement and influence in the community from serving upon the board.

It is important to note that if the director is also an officer or employee of the institution, other statutory restrictions as to amounts and types of loans apply.

Ethics Policy

The Department requests that the board of each financial institution adopt an ethics policy for their company. Upon adoption, the policy should be made available to all directors, officers, and employees. Documentation of an annual review of the policy with all directors, officers, and employees must be retained. Below is a sample policy. The sample may be modified or a current policy may be used but the financial institution's policy must address all of the points in the sample.

It is good business practice to inform all persons associated with the financial institution of the ethical standards that are expected. They are too important to be taken for granted. Additionally, such a policy may be important to the financial institution in the event of a legal action against the financial institution by a customer or former employee.

Sample Ethics Policy

All directors, officers and employees (DOE) are expected to understand, respect and comply with all of the laws, regulations, policies and procedures that apply to their position. While the financial institution is responsible for necessary training, responsibility rests with the individual.

All DOE should be scrupulous in avoiding any action or position that conflicts or gives the appearance of a conflict with the financial institution's interests. A conflict situation can arise when a DOE takes actions or has interests that may make it difficult to perform his or her duty for the financial institution objectively and effectively.

Conflicts may also arise when a DOE or a member of his or her family receives personal benefits as a result of the DOE's position with the financial institution, whether from a third party or from the financial institution. Conflicts of interest are often not clear-cut, so if a question arises, the DOE should consult with higher levels of management. In a case of a director, the matter should be brought to the entire board.

DOE must maintain the confidentiality of non-public information, acquired through the DOE's relationship with the financial institution, except when disclosure is specifically authorized by laws, regulations, or legal proceedings. Non-public information includes that which might be of use to competitors of the financial institution or harmful to the financial institution or its customers or employees if disclosed.

All of the financial institution's books, records, accounts and financial statements must be maintained in accurate detail, must appropriately reflect the financial institution's transactions and must conform both to applicable legal requirements and the financial institution's system of internal controls. Implicit in this accuracy is a prohibition of false, covert, or misleading entries.

Levels of authority for access to books, records, assets, and transactional devices of the bank have been established. These levels of authority are not to be avoided or exceeded.

If any DOE becomes aware of a violation of this Code of Ethics, or other violations of laws or regulations, or any potential fraud, that DOE must report the situation to an uninvolved supervisor, uninvolved board member, or appropriate outside regulatory authority.

Eleven Areas of Consideration for a Director

1. The director should be well known and respected in the community with an unquestioned reputation for integrity.
2. The director should be a successful individual in his/her own right and a leader in the community, as demonstrated by affiliation with community projects such as economic growth, development, and civic affairs.
3. The director must be capable of making sound, independent decisions based on facts and not on prejudices or personal interests.
4. The director must have a genuine interest in the office, regularly attend all meetings and keep well informed as to the affairs of the institution at all times.
5. The director must gain and maintain a thorough knowledge of the duties and responsibilities of his/her office.
6. The director must be capable of retaining confidences. Confidential information gained through the position is not to be divulged.
7. The director must give undivided loyalty to the financial institution charter over the owner and not have interests adverse to the institution.
8. The director must not use his/her office for personal benefit through information gained by virtue of his/her position.
9. The director must be capable of distinguishing between policy matters and management matters and be willing to refrain from unwarranted involvement in management functions.
10. The director must not lose sight of his/her primary responsibility, which is to safeguard the interests of the shareholders and depositors of that institution.
11. Common sense and fundamental values are of vital importance.

Chapter II

Mechanics of the Board's Operation

Directors' Qualifications

The Nebraska statutes set out several provisions relative to the qualifications and conduct of financial institution directors. The statutes require that a majority of the members of a bank have their residences in Nebraska or within 25 miles of the bank's main office. Neb. Rev. Stat. § 8-126 (LB 140 (2017)). A majority of the members of a trust company board must be residents of Nebraska. Neb. Rev. Stat. § 8-204 (Reissue 2012).

Reasonable efforts shall be made to acquire members of the board of directors from the county in which the main office of the bank is located and from counties in which branches of the bank are located. In the case of a trust company, reasonable efforts shall be made to acquire members of the board of directors from county in which the trust company is located. Each member of the board must be a person of good moral character, known integrity, business experience, and responsibility. Before any member of a board of directors can act in that capacity, he/she must be approved by the Department. Application forms for a director's approval are available from the Department or the Department's website, www.ndbf.nebraska.gov. Although not expressly set out in the Nebraska statutes, the same personal qualifications set out for commercial bank and trust company directors should be considered in selecting the directors of building and loan associations and credit unions.

Vacancies on the Board

When vacancies occur on the board of directors of a bank for any reason, the bank is required to notify the Department within 30 days from the time the vacancy occurs. Neb. Rev. Stat. § 8-124.01 (Reissue 2012). This is done by letter. Vacancies on the board of banks are to be filled within 90 days, except that if the vacancy created leaves a minimum of five directors, appointment is optional unless individual institution's bylaws require more members. Any vacancy may be filled by the affirmative vote of a majority of the remaining directors even though less than a quorum of the board of directors may be available. A bank or trust company director elected to fill a vacancy serves until the next election of directors. Section 8-124.01, Section 8-204.

Before a newly-elected bank or trust company director may act in an official capacity, the institution must apply to the Department for approval of that director and receive approval of that director by the Department. Forms are available for this purpose from the Department upon request or on the Department's website. Section 8-126 (LB 140 (2017)) and Section 8-204.

Stock-held building and loan associations should follow general corporation laws, which provide that a vacancy may be filled by the shareholders or by the affirmative vote of a majority of the remaining directors. A director elected to fill such a vacancy shall be elected for a term to expire at the next shareholders' meeting at which directors are elected. Neb. Rev. Stat. § 21-293 (Cum. Supp. 2016). The Nebraska statutes are silent on the procedure for filling vacancies on the boards of mutually-held building and loan associations; the procedures should be set forth in the institution's bylaws.

In the instance of a director vacancy in a credit union, the board of directors shall fill any vacancies occurring on the board unless the bylaws specifically reserve that power to the members. An individual appointed to fill a vacancy on the board shall serve the remainder of the unexpired term, except that he or she shall cease to serve immediately if he or she replaced a director who was suspended or removed by the board or the supervisory committee and the credit union membership reversed such suspension or removal. Neb. Rev. Stat. § 21-1760 (Reissue 2012).

Change of Control - Election of New Board of Directors

A change in control (25 percent or more of the stock changes hands or a party accumulates more than 25 percent of stock) of any bank, trust company, or holding company requires prior approval of the Department. Neb. Rev. Stat. §§ 8-1501 to 8-1502 (Reissue 2012). Forms are available for this purpose from the Department upon request or on the Department's website. The Department will notify the institution when a change in control may be effected.

Duration of Appointment

Each member of the board of directors for a bank, trust company, or building and loan association serves his/her term or until the next annual meeting of shareholders. Neb. Rev. Stat. § 21-288 (Cum. Supp. 2016). Credit union directors serve for a term as determined by the institution's bylaws. The terms are to be staggered. Neb. Rev. Stat. § 21-1758 (Reissue 2012). At the annual meeting, an election shall take place. If a vacancy occurs prior to the annual meeting of the members, the remaining directors may appoint someone to fill the vacancy, with Departmental approval, until the next annual meeting of the members. Neb. Rev. Stat. 21-293 (Cum. Supp. 2016), and §21-1760 (Reissue 2012).

Annual Meeting of the Board

Following the annual meeting of the stockholders or members, the elected directors should promptly hold an organizational meeting. Officers should be appointed, salaries fixed for the ensuing years, and any other business that might properly come before an organizational meeting should be transacted. The minutes of this meeting should clearly reflect the appointment of officers and the amounts of salaries approved for each. Credit unions are to notify the Department within 30 days of the annual meeting of the members of the names and addresses of board and committee members and officers. Neb. Rev. Stat. § 21-1759 (Reissue 2012).

Directors' Quorum

A simple majority of the total number of directors of a bank serving at the time shall constitute a quorum. Section 8-124 (LB 140 (2017)). The number of directors of a credit union shall be not less than five, and the membership of the supervisory and credit committees shall not be less than three. Neb. Rev. Stat. § 21-1758 (Reissue 2012). The statutes also do not expressly prescribe what constitutes a quorum for a credit union's board of directors or for a building and loan association's board of directors, but general corporation law states that a majority of the number of directors shall constitute a quorum. Neb. Rev. Stat. § 21-299 (Cum. Supp. 2016).

Majority Rule

The act of the majority of the directors present at a meeting at which there is a quorum shall be the act of the board of directors, unless the act of a greater number of directors is required by the articles of incorporation, articles of association, or the bylaws. This rule applies to all financial institutions. Section 21-299 and Neb. Rev. Stat. § 21-1768 (Reissue 2012).

Regular Meetings of the Board

Banks and trust companies are required to hold board meetings at least once in every calendar quarter, while credit unions must hold meetings not less frequently than once a month. Section 8-124 (LB 140 (2017)), and Neb. Rev. Stat. §§ 8-204 (Reissue 2012), 21-1767 (Reissue 2012). Regular meetings of the board of directors may be held with or without notice as specified in the bylaws. Neb. Rev. Stat. §§ 21-257 and 258 (Cum. Supp. 2016), Neb. Rev. Stat. § 21-1767 (Reissue 2012).

Board Meeting Attendance

It is incumbent upon each member of the board to attend board meetings on a regular basis. It is necessary that such meetings be held as frequently as conditions warrant. It is permissible for members to participate by telephone or other electronic means.

Infrequent board meetings make it difficult for directors to remain informed on important matters concerning the institution. Irregular attendance results in inadequate supervision. Every board member has a duty to the shareholders, members, depositors, and/or account holders to see that the institution is operated in a proper manner. When the directors accept election to the board, they become obligated to that responsibility. Directors allow their names to be used as assurance to the public that the institution will be properly supervised. To do less would be a disservice to the public trust, depositors, shareholders, or members.

Board Minutes

It cannot be overemphasized that accurate, complete, and detailed minutes are very important. Minutes are the institution's records reflecting the business conducted by the institution, showing the action taken by the board with respect to loans and investments as well as matters of a special or unusual nature. They represent the supervision extended by the board on these matters. Members must protect themselves by insisting upon full and complete minutes. This includes documentation of discussions and decisions made and attachments, if any are used, during the discussion.

Board Agenda

The board agenda should take the form that the directors are accustomed to in other organizations: Roll Call; Approval of Minutes of Previous Meetings, Committee Reports, Management and Other Reports; Old Business; and New Business. However, unlike the minutes of other boards, there are a number of topics that must be considered by the financial institution board at least annually or quarterly.

State and federal law place a number of requirements upon the board. State and federal rules and regulations further refine and define those statutes with more specific requirements. Upon review, a director will find that these rules and regulations require that the institution adopt a number of policies. It is the director's responsibility to insure that management and the board follow those policies. The institution's shareholders or members have provided articles of incorporation/association and bylaws that set forth an additional set of requirements the board must follow.

In addition to the above, there are a number of common sense issues that should be regularly addressed by the board. From personal experience with other businesses, a director, for example, might annually want to see a list of property and liability insurance policies or a summary of employee benefits.

The issues that the board is responsible for considering can appear to be overwhelming. The best way for a board to operate is to obtain from management a list of issues that must be reviewed during the year, along with the date(s) the issue will be dealt with. It is very helpful to have reports mailed several days in advance of meetings, but privacy of the institution's customers must be protected.

Resources

For commercial banks, the Nebraska Bankers Association publishes a loose-leaf series titled "NBA Compliance Handbook." The section on directors is an excellent resource that all new bank directors should review. This resource is also available electronically. For credit unions, the NCUA Handbook, Part V, will be helpful. It can be found on the NCUA website, www.ncua.gov.

Internet Resources

The Department's website is www.ndbf.nebraska.gov. Laws, rules, and forms can be found on the website.

The websites listed below point to information created and maintained by other public and private organizations. Please be aware that the Department does not control or guarantee the accuracy, relevance, timeliness, or completeness of this outside information. Reference in these web sites to any specific commercial products, processes, or services, or the use of any trade, firm or corporation name is for the information and convenience of the public, and does not constitute endorsement, recommendation, or favoring by the Department. The information provided is intended to be general information. It is not intended to take the place of either the written law or regulations.

- American Association of Bank Directors: www.aabd.org/resources
- Federal Deposit Insurance Corporation: www.fdic.gov
- *FDIC Directors Resource Center*: <https://www.fdic.gov/regulations/resources/director/>
- Federal Reserve Bank of Kansas City,
- FRB's Bank Directors Desktop: <http://bankdirectorsdesktop.org/>
- Federal Reserve Bank of St. Louis,
- *Insights for Bank Directors*: www.stlouisfed.org/col/director
- Independent Community Bankers of America, *Bank Director Program*: <http://www.icba.org/education/bank-director-program>
- National Credit Union Administration: www.ncua.gov
- Nebraska Bankers Association: www.nebankers.org
- Nebraska Credit Union League & Affiliates: www.nebrcul.gov
- Nebraska Independent Community Bankers: www.nicbonline.com
- Office of the Comptroller of the Currency,
- *Internal Controls: A Guide for Directors, Detecting Red Flags in Board Reports & The Director's Book—The Role of a National Bank Director*: www.occ.treas.gov/toolkit.htm

Chapter III

Supervisory Duties

Supervision by Directors

A director must exercise reasonable care and inform himself/herself of the institution's activities and act in good judgement based upon that information. The board must delegate the day-to-day routine of conducting the financial institution's business to its officers, but it cannot delegate responsibility for the consequences resulting from unsound or imprudent policies and practices.

Failure of the board to discharge its supervisory duties always leads to problems and may even lead to personal liability for losses incurred by the institution as a result of such negligence. How then may the board properly discharge its duties and responsibilities? They may be discharged in any manner selected, provided the board informs itself and uses reasonable care. This calls for the establishment of procedures that will bring to the board's attention all matters of importance in the affairs of the institution. Board members need to be inquisitive, and when information necessary on which to base a sound decision is not provided, they must take it upon themselves to obtain it.

The procedure outlined in the previous chapter relating to Regular Meetings of the Board should provide a basis for obtaining this information.

Appointment of Officers

The board of directors for a bank shall select from among its number a president Section 8-124 (LB 140 (2017)). The board of directors of a credit union shall select from among its number a chairperson and at least one vice chairperson, a treasurer, and a secretary. Neb. Rev. Stat. § 21-1764 (Reissue 2012). The Nebraska statutes are silent on appointments of officers for building and loan associations.

General corporation laws state that a corporation shall have the officers described in its bylaws and appointed in such a manner as may be prescribed by the corporation's bylaws. Neb. Rev. Stat. § 21-2,105 (Cum. Supp. 2016). All officers serve at the pleasure of the board and may be removed at any time by the board of directors. Section 8-124, Section 21-1764, and 21-2,108 (Cum. Supp. 2016).

Selecting Financial Institutional Management

One of the best ways to avoid problems in an institution is to provide for adequate management. Deficiencies in operations, investments, marketing, and personnel policies can be linked directly to management failing to carry out its duties, even after receiving adequate guidance from the board.

Effective management is dependent upon the institution's officers' ability to handle day-to-day business. Thus, the board not only has the responsibility to provide for capable management but also to provide managerial guidelines and policies.

Management Evaluation

The board must periodically appraise the performance of management based upon clearly defined standards and reward deserving employees. This is a valuable tool in providing for change or succession of management, if done on a regular annual basis.

Consideration of Management Change

Management's inability or unwillingness to effect improvements in areas frequently criticized by institution examiners, or to correct unsatisfactory situations called to management's attention by the board, may be reason to shift responsibility to other personnel within the institution or possibly even to replace an officer. As noted above, officers serve at the pleasure of the board; thus, the board has the authority and responsibility to make the changes it deems necessary.

Planned Succession of Officers

A danger of which the board should be cognizant is the lack of succession of management; that is, should the dominant officer become incapacitated, the financial institution would lack competent management. Such a managerial void may make the financial institution vulnerable to incompetent replacement leadership and create serious problems, including monetary losses to the financial institution. Strong input and leadership by each board member can guard against such a situation.

Management Workload

Officers should have sufficient opportunities within their schedules to review the institution's systems, operations, personnel matters, credit policies and management reports. The loan officer in an understaffed institution is often too busy assisting customers to do an effective job in either advancing credit or supervising loans once they are made. This same example can be applied to compliance issues, such as the Bank Secrecy Act (BSA), and confidentiality issues. The board should recognize that any officer must have sufficient time to devote to all appropriate duties. Burdensome responsibilities will distract from performance. Frequently, loan problems develop because a loan officer has little time to perform various functions relating to a particular line of credit, such as analyzing financial statements, reviewing file documentation, and making collateral inspections.

Management Salary

Salary is an important consideration and needs to be discussed as it relates to adequate management. The institution that has a competitive salary scale and is willing and able to pay for the officer it wants generally has no difficulty in providing suitable management. If, on the other hand, the institution has a restrictive salary program, hiring qualified candidates will be more difficult. This is particularly true with regard to the small institution, not only because of the limited earning capacity of the small institution, but also because the job may present limited promotional potential.

Management Training

Banking is a dynamic and changing industry. Not only do the mechanics of properly documenting banking transactions change almost annually, technology continues to force changes in the way financial institutions do their business. Federal law continues to place new restrictions and requirements on the way business is done.

Management of your financial institution must be provided the time and financial resources to attend meetings to update their knowledge and skills. "Too busy" cannot be an acceptable answer when asked what training your management has undertaken during the past year.

Planning

All successful businesses take the time to plan and budget. There are many ways to accomplish this task. Some employ consultants and spend several days at a retreat. Others sit down with senior management and the board to discuss an agenda of alternative courses the bank might follow. Your role is to encourage management to provide these planning sessions and to participate in them.

All institutions must have an annual financial budget and compare projections at least quarterly to actual results. Significant deviations must be explained.

The Relationship Between the Board and Financial Institution Management

- The director's job is to ensure that bank management is following the direction of board-approved policies and goals.
- Insist upon regular compliance reports that evaluate compliance with policies and regulations.
- Management information reports must be accurate and understandable.
- Understand the decisions being made. Do not get lost in charts or complex presentation. Insist on simple explanations.
- Know the management of the bank, including their personalities, tendencies, thoroughness, and honesty.

Chapter IV

Board Committees

Establishing Committees

Depending upon the size and complexity of the institution and its operations, the board may want to consider establishing committees to carry out certain functions required of the board. When committees are established, the minutes of directors' meetings should indicate cognizance and approval of action taken by such committees in exercising delegated authority ordinarily exercised by the board as a whole. The delegation of authority shall not operate to relieve the board of directors, or any member thereof, of any responsibility imposed by law. Neb. Rev. Stat. 21-2,100 (Cum. Supp. 2016). A credit union's committees shall be authorized by its bylaws, except for the supervisory committee.

Loan or Credit Committee

The loan committee/credit committee may be given authority to approve or disapprove all loans except insider loans, or approve or disapprove loans of a size or complexity that warrant special consideration. Approvals, as well as disapprovals, should be in writing, and a report of the action taken should be made a part of the board minutes at each meeting.

Among other responsibilities, the commercial bank loan committee may be given the responsibility to make livestock inspections, particularly those involving loans made under the exception provision of the bank's lending limit where an additional 10 percent may be loaned when livestock inspection amount equals or exceeds 115 percent of the amount of the note in excess of the base lending limit. When livestock inspections are made, the committee should be familiar with the provisions of 45 NAC 19 of the Rules of the Department which requires certain information to be contained in those reports, and sets time frames for those inspections. Department Statement of Policy #10 – Livestock Loans.

The board of directors of a credit union must establish written policies for a credit committee, credit manager, and/or loan officers. Neb. Rev. Stat. § 21-1769 (Reissue 2012.)

Investment Committee

The investment committee should oversee the institution's investment account, approve purchases and sales of securities, and periodically consider whether investment holdings are in line with the institution's objectives and needs regarding quality, safety, liquidity, income, secondary reserves and tax considerations.

The investment committee should conduct a review of the institution's holding of investment company shares (mutual funds). Factors which should be considered include: the institution's compliance with its investment policy and statutory and regulatory requirements, and careful review of the investment company's assets to determine whether the investment in that company is subject to certain limitations or is prohibited altogether. Such a review should be conducted at least quarterly, and the findings should be reported at the board meetings.

The investment committee should carefully consider the amount of gain or loss in the institution's investment securities and determine whether it is appropriate in view of the institution's characteristics. Factors which should be considered include the institution's liquidity position, the amount of its capital funds, its overall asset condition, and its earning capacity.

Asset/Liability Committee (ALCO)

The ALCO's primary areas of oversight and responsibility include monitoring and managing the bank's liquidity position and its interest rate risk/exposure, and the composition and maturity of the bank's assets and liabilities. To accomplish these goals, appropriate policies, internal controls, and accurate reporting and monitoring systems are required.

Examination or Audit Committee

The examination committee may be given the responsibility to make the directors' examination. Bank directors' examinations must comply with the provisions of 45 NAC 24 and 25; credit unions, 46 NAC 10 and 11. Building and loan associations are encouraged to establish an audit committee to handle relations with their independent auditor, to improve internal auditing functions and controls, and to establish policies to assure full disclosure of financial condition.

Chapter V

Directors' Examinations

Directors' Examination - Required Procedures

The board of directors of a bank or trust company is required to hold at least one regular meeting in each calendar quarter and, at one of these meetings annually, make a thorough examination of the institution's books, records, funds, and securities. Sections 8-124 and 8-204 and Department rules 45 NAC 24 and 25. The board is further required to keep a full and complete record of the proceedings and business of all its meetings and to make the record part of its minutes. Neb. Rev. Stat. § 8-125 (LB 140 (2017)).

There are few ways that directors are better able to inform themselves of their institution's condition and problems than by their own examination. The Nebraska Legislature recognized this and therefore made it mandatory by statute that the directors make an annual examination of the books, records, funds, and securities held by the financial institution. The Legislature further provided that, in lieu of this one required annual examination, the board may accept an audit by an accountant or accounting firm approved by the Department. Sections 8-124 and 8-204; 45 NAC 24.

With regard to a directors' examination, the Department has, by regulation, determined standards for acceptability and has set minimum examination procedures through the promulgation of 45 NAC 25 and 46 NAC 11. These standards must be complied with whether the directors make the examination themselves or have an accountant or accounting firm make the examination.

In the case of a credit union, it is the supervisory committee that shall annually audit the books and records of the credit union and make a full report of its affairs for the year to the board of directors. A summary of that report shall be given to each member at the annual meeting of the credit union. Neb. Rev. Stat. § 21-1771 (Reissue 2012) and 46 NAC 11.

Directors' Examination by a Certified Public Accountant or Public Accountant

In lieu of the one annual examination required by the board of directors of a bank or trust company, it may accept an audit by an accountant or accounting firm. Should the board of directors elect this option, it will be necessary that an application for approval (prior to retaining the firm) be made to the Department. Forms are available from the Department.

With respect to credit unions, in lieu of the one annual examination required by the supervisory committee, it may accept an audit by an accountant or accounting firm. Should the supervisory committee desire to have an accountant or an accounting firm perform the supervisory committee examination, it will be necessary that an application for approval (prior to retaining the firm) be made to the Department. Such forms are available from the Department. 46 NAC 11, Section 21-1771 (Reissue 2012).

45 NAC 24 sets forth standards that will be considered by the Department in approving accountants or accounting firms to perform this examination for banks. 45 NAC 24, as it applies to accountants or accounting firms, sets two requirements: first, the accountant or accounting firm must be a certified public accountant or a public accountant; second, the accountant or firm must meet the test of "independence." A person will not be considered independent if she, he, or the firm:

1. Is connected with the financial institution or any of its affiliates as an officer, director, attorney, or employee or is a member of the immediate family of an officer, director, attorney or employee of the financial institution or any of its affiliates;
2. Is the beneficial owner, directly or indirectly, of any shares of stock of the institution or any of its affiliates;
3. Has any proprietary interest in any partnership, firm, corporation, syndicate, or other business or legal entity which, directly or indirectly, controls the financial institution or any of its affiliates;
4. Is a borrower from the financial institution or any of its affiliates except with respect to:
 - (a) A loan on the security of his/her residence;
 - (b) A loan to make alterations, repairs, or improvements to his/her residence; or,
 - (c) A loan secured solely by his/her savings credits in a financial institution;
5. Makes entries or postings on the books of account or performs any other operating functions for the financial institution or any of its affiliates; or
6. Has any conflict of interest, or the appearance thereof, by reason of business or personal relationships with management or its decisions or functions.

In addition, if any partner or principal of the accounting firm receives any special consideration in any transaction with the financial institution or its affiliates or has any interest, directly or indirectly, financial or otherwise in any real property owned by or securing any loan made by the financial institution or any of its affiliates except as provided in the fourth point of this subdivision, or in any other operating activity or function of the institution or any of its affiliates; the accountant and firm will not be considered independent.

46 NAC 11 sets forth standards that will be considered by the Department in approving accountants or accounting firms to perform this examination for credit unions. 46 NAC 11 is very similar to 45 NAC 24. 46 NAC 11, as it applies to accountants or accounting firms, sets forth the same two requirements as 45 NAC 24: first, that the accountant or accounting firm must be a certified public accountant or a public accountant; second, the test of "independence" be met. An accountant examining a credit union will not be considered independent if he or she:

1. Is connected with the credit union as an officer, committee member, director, attorney, or employee;
2. Is the beneficial owner, directly or indirectly, of five percent or more of the shares of the credit union;
3. Is a borrower of the credit union;
4. Makes entries or postings on the books of account or performs any other operating functions for the credit union; or in addition, if any partner or principal of the accounting firm receives any special consideration in any transaction with the credit union or has any interest, directly or indirectly, financial or otherwise in any real property owned by or securing any loan made by the credit union, or in any other operating activity or function of the institution; the accountant and firm are not considered independent;
5. Has any substantial conflict of interest, or the appearance thereof, by reason of business or personal relationships with management or those individuals who are in a position to influence management or its decisions or functions.

In addition, if any partner or principal of the accounting firm receives any special consideration in any transaction with the financial institution or its affiliates or has any interest, directly or indirectly, financial or otherwise in any real property owned by or securing any loan made by the financial institution or any of its affiliates except as provided in the fourth point of this subdivision, or in any other operating activity or function of the institution or any of its affiliates; the accountant and firm will not be considered independent.

These points are not all-inclusive, but rather set forth the most common conditions which contribute to a lack of independence. All questions relating to independence of an auditor must be resolved with the Department prior to engagement of the auditor.

Directors' Examination Performed by Other Than a Certified Public Accountant or a Public Accountant

If the directors' examination is performed by someone other than a certified public accountant, a public accountant, or the board itself, it must still be performed in accordance with governing rules.

The board must verify the correctness of the report, with a majority so attesting by signature, and make it a part of the records of the institution.

Chapter VI

Developing a Lending Policy

Purpose of a Written Policy

The lending of money is an important responsibility which an institution is called upon to perform in its community. It is important for the board to recognize that the lending of funds involves a degree of risk and that such risks can only be minimized by sound lending guidelines. It is the board's responsibility to formulate and administer an adequate and sound written lending policy.

The purpose of a written lending policy is to act as a guide to management in establishing responsibility and insure that officers shall not engage in any practices which are unsafe or unsound or which result in a violation of law, rule, or regulation. A lending policy should not be a static document, but should be reviewed and revised periodically in light of changing circumstances surrounding the institution and its customers.

A lending policy should clearly spell out the basis on which loans are to be made and serviced, and encourage management to meet the credit needs of the entire community, including low- and moderate-income neighborhoods.

Principles of Lending

1. Know the reason for the borrowing. Loans should be made only for acceptable purposes.
2. Obtain adequate credit information. It is important to know the borrower's earning power and cash flow.
The assumption that a customer is a good risk because he or she is known in the community may result in a bad loan.
3. Provide for a definite repayment plan. Reliance upon collateral without provision for repayment may result in foreclosure upon the collateral to attempt avoidance of loss.
4. Provide for adequate collateral. Collateral becomes a contingent means of repaying a loan.
Financing Statements and Deeds of Trust must be properly filed or they are worthless.
5. The customers cannot be allowed to dictate the terms of the loan. For whatever reason—competition or otherwise—the loan officer who allows the customer to dictate terms will lose control over the loan, and the financial institution may become an involuntary partner in the customer's business.

Important Guidelines

1. Insist on a list of loans made that are exceptions to policy guidelines. This list must be updated for each board meeting.
2. Know the largest problem loans, why they are problems, and what is being done to collect or improve them.
3. Determine if loans are being kept current with liberal extensions, new loans to pay interest or additional loans.
4. Beware of lending to a single industry or when there is a single source of repayment of a number of loans.
5. Do not get into any business lines or loan programs unless there is demonstrated expertise to manage them.
6. Frequently review and monitor past-due and non-performing loans.
7. Review and require correction of documentation exceptions.
8. Monitor loan officer expenses.

Policy Outline

- A. General Policy
 - 1. Function
 - 2. Area of Service
 - 3. Acceptable Risk
 - 4. Compliance with Consumer Loan Regulations

- B. Supervision - Responsibility
 - 1. Board of Directors
 - 2. Chairperson of Loan Committee
 - 3. Loan Committee
 - 4. Licensed Officers

- C. Administration
 - 1. Chairperson of Loan/Credit Committee
 - 2. Loan/Credit Committee
 - 3. Licensed Officers
 - 4. Reporting to Board

- D. Organization of Loan/Credit Committee
 - 1. Composition - Appointments by Board
 - a. Chairperson
 - b. Members
 - 2. Frequency of Meetings
 - 3. Responsibilities
 - 4. Reporting to Board

- E. Lending Authorities
 - 1. Delegation by Board
 - 2. Lending Authority Limits
 - a. Individual Licensed Officer
 - b. Loan/Credit Committee for larger loans

- F. Trade Area
 - 1. Defined geographically

- G. Interest Rates
 - 1. Determination of prevailing rates
 - 2. Differentials
 - a. Type of Loan
 - b. Risk
 - c. Collateral

H. Type of Loans

1. Commercial/Business
 - a. Short-term Working Capital
 - b. Marketable Inventory
 - c. Assignment of Accounts Receivable
 - d. Purchase of Securities
 1. U.S. Government Securities
 2. Listed Securities
 - e. Other Collateral Loans
 1. Warehouse Receipt
 2. Certificate of Deposit/Savings Accounts
 - f. Small Business Administration Guarantee
 - g. Real Estate/Commercial Property
 1. Interim Construction
 2. Permanent Financing
2. Agricultural Loans
 - a. Operating
 - b. Livestock Feeder
 - c. Cow/Calf
 - d. Dairy Herd
 - e. Crop
 - f. Machinery/Equipment
 - g. Real Estate/Farmland
 - h. Other
3. Consumer/Installment
 - a. Household/Personal
 - b. Consumer Goods
 - c. Improvement
 - d. Automobile
 - e. Mobile Homes
 - f. Other/Credit Card and Related Plans
 - g. Overdraft Protection Plans
4. Real Estate Loans
 - a. Construction
 - b. Residential
 1. Insured FHA & Guaranteed VA
 2. Conventional
5. Letters of Credit

I. Credit Determination

1. Financial Analysis - Net Worth/Cash Flow
2. Collateral Adequacy and Desirability
3. Credit Information/Sources/Historical
4. Compliance with Consumer Regulations

J. Maintenance of Credit Files

1. Loan Applications
2. Notes

3. Security Agreements/Financing Statements
4. Financial Information
5. Guarantees
6. Corporate Documentation
7. Real Estate Documentation
8. Memoranda by Loan Officer Regarding Borrower
9. Other Pertinent Documentation

K. Handling of Marginal Loans

1. Collections/Repossession/Foreclosure
2. Reviewing Delinquent Loans
3. Charge-off Procedure
 - a. Follow-up
 - b. Recovery Procedure
4. Reporting to Board

Chapter VII

Customer Information Security Policy

Purpose of a Written Policy

A Customer Information Security Policy (CISP) is recent addition to the list of required bank policies; however, it may be the most encompassing policy. Until relatively recently, information collected by the bank largely belonged to and could be controlled by a bank and theft without taking was typically not a concern of a bank. In today's world, theft without taking can easily cost the institution more than theft by taking. To address the various assets held by a bank and the safeguards put into place to protect bank assets, the CISP becomes a planning tool, an emergency plan and even a disaster notification and recovery process if properly constructed.

Policy and Program Addressing Security

The CISP serves as a guidance document regarding information policies and plans. It originates from the wording within the Gramm-Leach-Bliley Act¹ that requires a bank to:

- Ensure the security and confidentiality of customer information;
- Protect against any anticipated threats or hazards to the security or integrity of such information;
- Protect again unauthorized access to or use of customer information that could result in substantial harm or inconvenience to any customer.

Technically, a policy is a high level guidance document offering board direction to bank management. A program is management's document, incorporating board direction into a flow of information that will accommodate the board's instruction. A CISP is required to address both policy and program issues. While a program is not as detailed as a work manual, a program must address the various areas at issue. California is often credited with the first law requiring a financial institution to disclose a security breach to the public. While the California legislation² can be considered when establishing "anticipated threats," other laws more closely regulate Nebraska information. FACTA (Fair and Accurate Credit Transactions Act)³ directly applies to customer information in Nebraska institutions in a number of ways. For example, data destruction detailed:

- Burning, pulverizing or shredding of physical documents
- Erasure or destruction of all electronic media
- Contracts with third parties involving data destruction.

Additionally, the necessity to comply with the Bank Secrecy Act (BSA)⁴ is common knowledge— due to recent enforcement emphasis. However, the disclosure of a SAR (Suspicious Activity Report) may be a felony. The process of handling and mishandling information creates risks of loss to the institution and risk of loss to the individuals involved. The CISP is the process or the document where the bank can explain how its management of paper, electronic, and knowledge-based information is secure. The purpose of all the cited legislation or regulation is for the bank to formally address the due care exercised by the bank as a secure holder of customer information.

¹Full text of Graham Leach Bliley 501(b) : <http://www.fdic.gov/news/news/financial/2001/fil0122a.html>

²California Law requiring notice to residents of security breach: http://info.sen.ca.gov/pub/01-02/bill/sen/sb_1351-1400/sb_1386_bill_20020926_chaptered.html

³FACTA full text: <http://financialservices.house.gov/media/pdf/108hr2622ai.pdf>

⁴BSA reference page: <http://www.fdic.gov/regulations/examinations/bsa/>

Chapter VIII

Developing an Investment Policy

Purpose of a Written Policy

The investment portfolio may constitute a significant percentage of an institution's earning assets. Because of this, management must be provided with written guidelines to assure the institution's investment objectives are being met. The written policy also provides the board with a method of monitoring management compliance with stated goals and objectives.

The guidelines and monitoring process provide a consistent plan and are particularly important in light of changing personnel and the many exotic and divergent investments that are available today. For credit unions, Section 21-1768 (Reissue 2012) and the NCUA Agreement for Share Insurance requires a credit union to have a formal, written investment policy.

Cornerstones of an Investment Policy

The main objective of a well-conceived policy is to furnish guidance in maintaining an investment portfolio that, along with supplementing a good quality asset base, takes into consideration the institution's needs for liquidity, flexibility of operation, and earnings.

For directors to meet their responsibility of policy formulation, they must provide a policy which establishes all appropriate parameters, including minimums and maximums, acceptable investments, unacceptable investments, and investments which are legal for their institution to purchase.

The board must assure that the parameters of the investment policy do not exceed the expertise of management. The written investment policy should thoroughly consider quality, maturity, diversification, marketability, and income.

Quality

The quality of available investments varies widely. The policy should provide guidelines for the quality of investments that are acceptable, taking into account the risk factor and other portfolio determinants discussed below.

Maturity

The appropriate maturity distribution is unique to each individual institution. A sound maturity distribution will consider the institution's loan demand, availability of funding sources, and seasonal trends which institutions experience.

Heavy investment in longer-term maturities assumes alternative favorable investments will not be available over the maturity purchased. This judgment, when dealing with longer maturities, is difficult to determine. Due to fluctuations in interest rates and prices, a long maturity distribution may present considerable risks.

Diversification

The correct level of diversification will avoid the risks inherent in purchasing a portfolio dominated by one issuer or a group of issuers, which function under common factors or circumstances.

Marketability

Marketability is essential for a large part of the investment portfolio. Concentrations in obscure issues are not desirable because such investments may be difficult to liquidate to meet potential cash demands or even be unsuitable to pledge as collateral for loans.

Conversely, marketability by itself does not qualify an issue for investment by an institution. Some defaulted issues may have readily available quotes; this alone does not make them suitable investments.

Income

Income is certainly a consideration when purchasing investments, but this factor should not become the main consideration when making investment decisions. High yields are almost always coupled with high risks. Issues on which yields are significantly above others available in the market should be carefully investigated.

Securities Dealers

The policy should contain a list of approved firms that the institution may use to buy and sell securities. It is wise to obtain financial information from these firms annually. Management should explain any changes to the list they recommend.

Developing a Funds/Asset-Liability Management Policy

Purpose of a Written Policy

Funds or asset-liability management refers to the overall control of the composition of the balance sheet accounts. Control of these accounts is necessary to generate optimum levels of earnings and to maintain sufficient liquidity to meet both predicted and unexpected cash needs. Cash needs typically arise from meeting customer loan demand or providing for withdrawals. The increasing volatility in funding sources and market rates resulting from the removal of interest rate limitations and rapid fluctuation in the economy have made effective funds management essential to successful operation. Accordingly, management must be provided written guidelines to assure that the institution's earnings and growth objectives are prudently met.

Critical Areas of a Funds/Asset-Liability Management Policy

The policy should establish responsibility for planning and day-to-day funds management decisions. In addition, the policy should establish parameters which will allow the institution to maximize its earnings and growth objectives in a safe and sound manner. These parameters include establishing limits on the rate-sensitivity position, exposure to asset concentrations, restrictions on the loans-to-assets or loans-to-deposits ratios and limits on the reliance on a particular funding source.

Another area which should be addressed in the policy is off-balance sheet activities. Activities of this nature, which involve commitments to take on assets or liabilities at a future date, have grown rapidly as institutions diversify products and sources of income. Off-balance-sheet transactions include commitments to purchase securities, standby letters of credit and loan commitments. Although these transactions are not represented on the institution's balance sheet, they can involve very significant funding and/or credit risks.

The policy should also address a contingency funding plan which describes how the institution will meet any unusual or unanticipated liquidity needs. The plan should consider the stability of funding sources, marketability of assets and the alternative funding sources available.

The making of sound asset-liability management decisions depends in large part on the management information system used by the institution. The board should insure that the management information system provides accurate and timely reports for use by both management and the board.

As previously indicated, the funds/asset-liability management policy provides guidance in the overall control of balance sheet accounts. Consequently, the strategies implemented by the board's policy affect all areas of the financial institution, including the lending and investment functions. Correspondingly, all policies, including loan and investment policies, will need to be reviewed to determine that the strategies implemented in them are consistent with each other.

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