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# Financial Institution Directors: Duties & Responsibilities

## The Nebraska Department of Banking & Finance

Nebraska's Banking & Finance Regulators since 1890.



**NDBF**  
NEBRASKA DEPARTMENT  
OF BANKING AND FINANCE

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## Foreword

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This booklet, compiled by the Nebraska Department of Banking and Finance, is intended to aid members of the board of directors of a financial institution to better understand their duties and responsibilities. The booklet is designed for the newly selected director who often times is appointed without any formal training. It is written to help explain and clarify the supervisory duties of a director. This booklet is not intended to address all of the issues and responsibilities assumed by a director.

To be an effective director, you must 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 regulators.

A director must 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.

As a director, you need to understand your functions and legal responsibilities. It is important that you perform your duties in a manner that avoids legal liability to you and your financial institution, as well as assure that detailed records of the board's decision making process are maintained.

Finally, a director needs to evaluate the effectiveness of board policies in accomplishing the institution's 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 setting goals and objectives.

This booklet 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 the 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 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 is also available on the Department Web site at <http://www.ndbf.ne.gov>.



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# Chapter I - The Director's Role

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## **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 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 also on funds of persons other than the stockholders. Accordingly, a special fiduciary relationship of directors to the public is created, 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 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 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. Should members serve on special committees, they might properly receive additional compensation at the discretion of the board.<sup>1</sup> 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.<sup>2</sup>

## **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, violate the directors' role of trust. Loans advanced by a bank to a member of its board or a related interest of that member over a specified amount must be specifically approved by the board before any funds are advanced.<sup>3</sup>

Any loan advanced to an official of a 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.<sup>4</sup>

While there is no express statute relating to borrowings of building and loan directors, the guidelines set forth in statutes for other financial institutions certainly apply to building and loan associations. The financial institution's primary federal regulator 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 should be specifically noted in the minutes of that meeting, and must be detailed if over a certain amount. 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 judgment 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 respected in the community with an unquestioned reputation for integrity.
2. The director should be a successful individual in his/her own right and be active 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.

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### **Referenced Nebraska Statutes**

<sup>1</sup> Neb. Rev. Stat. § 21-2088 (Reissue 2007)

<sup>2</sup> Neb. Rev. Stat. § 21-176 (Cum. Supp. 2007)

<sup>3</sup> Neb. Rev. Stat. § 8-143.01 (Cum. Supp. 2008)

<sup>4</sup> Neb. Rev. Stat. § 21-1796 (Reissue 2007)

## Chapter II – Mechanics of the Board’s Operation

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### **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.<sup>5</sup> Unless the Department approves otherwise, a majority of the members of a trust company board must also be residents of Nebraska. In addition, reasonable efforts are to be made to acquire members for the board of directors from the county in which the trust company is located. All trust company board members are to be elected by and from their stockholders.<sup>6</sup>

Each member of the board must be a person of good moral character, known integrity, business experience, and responsibility. No person may act in an official capacity as a bank or trust company director until the institution applies for and obtains approval from the Department.<sup>7</sup> Forms are available for this purpose from the Department upon request or on the Department’s Web site at [www.ndbf.ne.gov](http://www.ndbf.ne.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**

Any time that a vacancy occurs on the board of directors, a bank is required to notify the Department within 30 days. Vacancies are required to be filled within 90 days by the appointment of the remaining directors. The appointment of a director shall be optional if the vacancy created leaves a minimum of five directors, unless the individual institution’s bylaws require more members. When the vacancy has been filled, the bank shall notify the Department and include in the notice the name, address, and occupation of the appointed director.<sup>8</sup>

The requirements for reporting and filling the vacancies for a trust company are basically the same as banks, except a director elected to fill a vacancy serves until the next election of directors.<sup>9</sup>

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.<sup>10</sup> 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.<sup>11</sup>

### **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.<sup>12</sup> Forms are available for this purpose from the Department upon request or on the Department's Web site. A change in control may be effected at any time after Departmental approval.

If a bank had three directors prior to September 2, 1973 (when the minimum was raised to five with a maximum of 15) and thereafter a change in control occurs, the minimum number of board members must be increased to five.<sup>13</sup> The bank must then make application to the Department for approval of the newly-elected board members.

### **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.<sup>14</sup> Credit union directors serve for a term as determined by the institution's bylaws. The terms are to be staggered.<sup>15</sup>

### **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 provide the Department within 30 days after the annual meeting, a record of the names and addresses of the members of the board of directors, committees, and its officers.<sup>16</sup>

### **Directors' Quorum**

A simple majority of the total number of directors of a bank serving at the time shall constitute a quorum. A bank is to be managed by a board of directors of not less than five and not more than fifteen members, although any bank chartered prior to September 1, 1983, which has not had 25 percent or more of its stock transferred since that date may have a minimum of three directors.<sup>17</sup> 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.<sup>18</sup> 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.<sup>19</sup>

### **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.<sup>20</sup>

### **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.<sup>21</sup> Unless the articles of incorporation or bylaws provide otherwise, regular meetings of the board of directors may be held without notice of the date, time, place, or purpose of the meeting.<sup>22</sup>

### **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. Although not recommended, 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. Such 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, 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 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 (NBA) publishes a loose-leaf series titled *NBA Compliance Handbook*. The section on directors is an excellent resource that all new bank directors should review. The NBA Web site address is [www.nebankers.org](http://www.nebankers.org).

For credit unions, the *NCUA Handbook Part, V*, will be helpful. It can be found on the NCUA Web site, [www.ncua.gov](http://www.ncua.gov).

Nebraska laws, rules, and forms can be found on the Department's Web site at: [www.ndbf.ne.gov](http://www.ndbf.ne.gov)



## Other Internet Resources

The Web sites 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 to these Web sites does not constitute endorsement, recommendation, or favoring by the Department. The information provided is intended to be general information.

- American Association of Bank Directors: [www.aabd.org/resources](http://www.aabd.org/resources)
- Federal Deposit Insurance Corporation: <http://www.fdic.gov/>
- Federal Reserve Bank of Kansas City: <http://www.kc.frb.org/>

Training for Bank Directors:

- Insights for Bank Directors: [www.stlouisfed.org/col/director](http://www.stlouisfed.org/col/director)
- Independent Community Bankers: [www.nicbonline.com](http://www.nicbonline.com)
- National Credit Union Administration: [www.ncua.gov](http://www.ncua.gov)
- Nebraska Bankers Association: [www.nebankers.org](http://www.nebankers.org)
- Office of the Comptroller of the Currency, [www.occ.treas.gov/tookit.htm](http://www.occ.treas.gov/tookit.htm)  
*Internal Controls: A Guide for Directors; Detecting Red Flags in Board Reports; and The Director's Book—The Role of a National Bank Director.*

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## Referenced Nebraska Statutes

<sup>5</sup> Rev. Stat. § 8-126 (Cum. Supp. 2007)

<sup>6</sup> Neb. Rev. Stat. § 8-204 (Reissue 2007)

<sup>7</sup> Neb. Rev. Stat. §§ 8-126, 8-204 (Reissue 2007)

<sup>8</sup> Neb. Rev. Stat. § 8-124.01 (Reissue 2007)

<sup>9</sup> Neb. Rev. Stat. § 8-204 (Reissue 2007).

<sup>10</sup> Neb. Rev. Stat. § 21-2082 (Reissue 2007)

<sup>11</sup> Neb. Rev. Stat. § 21-1760 (Reissue 2007)

<sup>12</sup> Neb. Rev. Stat. §§ 8-1501 to 8-1502 (Reissue 2007)

<sup>13</sup> Neb. Rev. Stat. § 8-124 (Reissue 2007)

<sup>14</sup> Neb. Rev. Stat. § 21-2082 (Reissue 2007)

<sup>15</sup> Neb. Rev. Stat. § 21-1758 (Reissue 2007)

<sup>16</sup> Neb. Rev. Stat. § 21-1759 (Reissue 2007)

<sup>17</sup> Neb. Rev. Stat. § 8-124 (Reissue 2007)

<sup>18</sup> Neb. Rev. Stat. § 21-1758 (Reissue 2007)

<sup>19</sup> Neb. Rev. Stat. § 21-2093 (Reissue 2007)

<sup>20</sup> Neb. Rev. Stat. § 21-2093 (Reissue 2007),

Neb. Rev. Stat. § 21-1768 (Reissue 2007)

<sup>21</sup> Neb. Rev. Stat. §§ 8-124 (Reissue 2007); 8-204 (Reissue 2007); 21-1767 (Reissue 2004)

<sup>22</sup> Neb. Rev. Stat. § 21-2091 (Reissue 2007)

## Chapter III – Supervisory Duties

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### **Supervision by Directors**

A director must exercise reasonable care and inform himself/herself of the institution's activities and act in good judgment 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.

### **Appointment of Officers**

The board of directors of a bank shall appoint a secretary and, from among its own members, select a president.<sup>23</sup> The board of directors of a credit union shall elect from among its number a chairperson, one or more vice chairpersons, a treasurer, and a secretary, at the organizational meeting held as provided in the bylaws.<sup>24</sup> 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 or appointed by the board of directors in accordance with the bylaws.<sup>25</sup> All bank and corporate officers serve at the pleasure of the board and may be removed at any time by the board of directors.<sup>26</sup> The terms of credit union officers shall be for one year or until their successor are chosen and have been duly qualified.

### **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 should consider a system to reward deserving employees. This is a valuable tool in providing for change or maintaining capable management if done on a regular 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 a key officer become incapacitated, the financial institution could 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 and internal control issues, such as the Bank Secrecy Act (BSA), Information Technology (IT), 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. Loan problems often 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.

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## **Referenced Nebraska Statutes**

<sup>23</sup> Neb. Rev. Stat. § 8-124 (Reissue 2007)

<sup>24</sup> Neb. Rev. Stat. § 21-1764 (Reissue 2007)

<sup>25</sup> Neb. Rev. Stat. § 21-2097 (Reissue 2007)

<sup>26</sup> Neb. Rev. Stat. §§ 8-124 and 21-20,100 (Reissue 2007)

## Chapter IV – Board Committees

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### **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.<sup>27</sup> 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 *Title 45 Chapter 19* of the Department's administrative rules which requires certain information to be contained in those reports, and sets time frames for those inspections.

### **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.

### **Audit Committee**

The audit committee may be given the responsibility to conduct the directors' examination. Bank directors' examinations must comply with the provisions of the Department's administrative rules, specifically, *Title 45 Chapters 24 and 25* for banks, *Title 46 Chapter 10 and 11* for credit unions. 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.

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### **Referenced Nebraska Statutes**

<sup>27</sup> Neb. Rev. Stat. § 21-2094 (Reissue 2007)

### **Referenced Administrative Rules & Regulations**

Title 45 Chapter 19 – Banking Rules: Livestock Loans

Title 45 Chapter 24 – Banking Rules: Directors Examinations Performed  
by Certified Public Accountants and Public Accountants

Title 45 Chapter 25 – Banking Rules: Standards for Acceptability and Scope of Examinations  
for Directors' Examinations

Title 46 Chapter 10 – Industrial, Saving & Loan, Credit Union Rules:  
Supervisory Committee's Quarterly Inspections

Title 46 Chapter 11 – Industrial, Saving & Loan, Credit Union Rules:  
Supervisory Committee's Annual Audit

## Chapter V – Director’s Examinations

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### **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.<sup>28</sup> 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.<sup>29</sup>

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.<sup>30</sup>

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 administrative rules *Title 45 Chapter 25 and Title 46 Chapter 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.<sup>31</sup>

Building and loan associations that are federally insured are required by the Office of Thrift Supervision to be audited at least once in each calendar year by independent auditors. Such associations should be aware of the required auditing procedures and report contents.

### **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 on the Department’s website at [www.ndbf.ne.gov/forms/audit.pdf](http://www.ndbf.ne.gov/forms/audit.pdf).

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 on the Department’s website at [www.ndbf.ne.gov/forms/audit.pdf](http://www.ndbf.ne.gov/forms/audit.pdf).<sup>32</sup>



The Department's administrative rule *Title 45 Chapter 24* sets forth standards that will be considered by the Department in approving accountants or accounting firms to perform this examination for banks. The rule, 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
  - (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.
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.

Administrative rule *Title 46 Chapter 11* sets forth standards that will be considered by the Department in approving accountants or accounting firms to perform this examination for credit unions. *Title 46 Chapter 11* is very similar to *Title 45 Chapter 24*. *Title 46 Chapter 11*, as it applies to accountants or accounting firms, sets forth the same two requirements as *Title 45 Chapter 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.



5. 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; or 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.

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.

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### **Referenced Nebraska Statutes**

<sup>28</sup> Neb. Rev. Stat. § 8-124 (Reissue 2007), Neb. Rev. Stat. § 8-204 (Reissue 2007)

<sup>29</sup> Neb. Rev. Stat. § 8-125 (Reissue 2007)

<sup>30</sup> Neb. Rev. Stat. § 8-124 (Reissue 2007), Neb. Rev. Stat. § 8-204 (Reissue 2007)

<sup>31</sup> Neb. Rev. Stat. § 21-1771 (Reissue 2007)

<sup>32</sup> Neb. Rev. Stat. § 21-1771 (Reissue 2007)

### **Referenced Administrative Rules & Regulations**

Title 45 Chapter 24 – Banking Rules: Director's Examinations Performed by Certified Public Accountants or Public Accountants

Title 45 Chapter 25 – Banking Rules: Standards for Acceptability and Scope of Examinations for Directors' Examinations

Title 46 Chapter 11 – Industrial, Saving & Loan, Credit Union Rules: Supervisory Committee's Annual Audit

## Chapter VI – Developing a Lending Policy

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### **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 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 – Information Technology

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### Introduction

Information technology (IT) reflects more than the back room of the bank: IT is the process of proving capital, measuring liquidity and protecting the information of the bank. Data breaches, insider misconduct and legal compliance add complexity to the world of IT. Legal IT guidance is a blend of Automated Clearing House (ACH), Gramm Leach Bliley Act (GLBA), Health Insurance Portability and Accountability (HIPPA), and various rules and regulations.

Technology has not only transformed the bank back room into a profit center but also into a risk center. Simply saying a computer system is “safe,” may or may not mean the bank’s access to information is safe from a power outage, a tornado, hacking, insider theft, miscalculation, redirected transmissions or other threats. As a director, the question is not, is our computer system safe? The question is, how prepared is the institution for potential computer infrastructure security risks and threats?

The evaluation of any large process requires learning details. For purposes of this introduction IT is defined as 1) Audit; 2) Business Continuity Planning; 3) Development and Acquisition; 4) Electronic Banking; 5) Information Security; 6) Management; 7) Operations; 8) Outsourcing and Supervision of Technology Service Providers; and finally, 9) Retail and Wholesale Payment Systems. Each of these topics is defined in a booklet published by the Federal Financial Institution Examination Council (FFIEC). Significant portions of this document were created in reference to FFIEC guidance.

The FFIEC booklet and check sheets can be found at: <http://www.ffiec.gov/ffiecinfobase/index.html>

### Audit

Establishing a review process, whether by a team or an individual that internally audits the bank’s compliance with the board instructions, is a critical function of an IT auditing process. Every bank, regardless of size must have an IT audit review process. The internal IT audit should consist of a risk focused summary of management expectations and checks or measurements which reflect confirmation that the processes were completed.

Routinely discussed IT audits include:

1. ACH audit. Internal or External review of ACH operations and risks
2. PCI DDS audit. May be applicable depending upon Card Processing
3. IT Audit. This document maybe internal or external, but must reflect a review of select processes, practices and logs. Depending upon bank size or risk, an external IT audit may be desirable or recommended by regulatory guidance. While audits should be tailored to address the weakest or highest risk areas, a basic audit will seek to determine the following:
  - a. Inappropriate user access to information systems
  - b. Unauthorized disclosure of confidential information
  - c. Unreliable or costly implementation of IT solutions
  - d. Inadequate alignment between IT systems and business objectives
  - e. Inadequate systems for monitoring information processing and transactions

- f. Ineffective training programs for employees and system users
- g. Insufficient due diligence in IT vendor selection
- h. Inadequate segregation of duties
- i. Incomplete or inadequate audit trails
- j. Lack of standards and controls for end-user systems
- k. Ineffective or inadequate business continuity plans
- l. Financial losses and loss of reputation related to systems outages

### **Business Continuity Planning**

Home planning for a power outage likely includes flashlight and batteries. However a power outage to a bank creates questions about overnight clearing, security systems, remote ATMs, point of sale, availability to time locked vaults, sump systems, fire protection, increased likelihood of loss to fraud or theft, and the list goes on. In the place of preparing for each event such as storms, flood, fire, pandemic, spilled contaminants from a train wreck or a truck collision, the board should see that plans are in place to stay prepared for what no one wants to happen.

During a catastrophe, people will be unavailable, resources limited and options expensive. Beginning with a business impact analysis, the bank should measure the costs associated with various events, as well as the likelihood of such an event.

Thus preparing for power outage is likely higher on the list than preparing for an event that makes the bank unavailable. Enterprise wide planning need not contain long lists of what could happen, rather, the list should reflect the bank's response to loss of resources. For instance, several events may result in the loss of power; however the steps to continue to get the work done without power are uniform.

Typical considerations include:

- a. Board and Senior Management Responsibilities
- b. Business Continuity Planning Process
- c. Business Impact Analysis
- d. Risk Assessment
- e. Risk Management
- f. Risk Monitoring and Testing
- g. Other issues may include – security standards, data synchronization procedures, remote access, insurance, government and community issues.

### **Development and Acquisition**

It is widely accepted that today's profit margins require an element of automation. The days of rooms of people filing checks, running proof and posting to ledgers are gone to the nearly silent hum of a computer's fan. IT decisions have become complex. Decisions must reflect sufficient research to explain the cost and the time necessary to make changes. Cost overruns due to custom code software are common and yet with planning, the costs and time associated with development and acquisitions are quantifiable.

Typical discussions regarding Development and Acquisition include:

- a. Project Plans

- b. Configuration management
- c. Quality assurance
- d. Risk management
- e. Testing
- f. Documentation

### **Electronic Banking**

In today's world, a bank must consider how their customers will have access to their bank account information. Whether access is via ACH, ATMs, point of sale, cell phone or the Web, a periodic discuss as to the electronic delivery of services, access to funds and use of private or public networks deserves attention. Simply because a bank does not have an electronic offering, does not eliminate the losses due to electronic fraud. However, to keep electronic banking separate from security; generally, electronic banking discussions include:

#### Risks:

- a. Transaction or operation risk
- b. Credit risk
- c. Liquidity, interest rate, price and market risk
- d. Compliance risk

#### Oversight:

- a. Board & Management
- b. Managing outsourcing relationships
- c. Information Security
- d. Administrative Controls
- e. Legal and compliance issue

### **Information Security**

Information Security is well defined for a bank with various overlapping guidance documents. While reporting requirements will vary, Gramm Leach Bliley (GLBA) is the most encompassing, and thus a reasonable single source document from which to create a security process. GLBA requires a bank to develop and implement an information security program. The process shall:

#### A. Involve the Board of Directors

- a. The Board shall: Approve the bank's written information security program and:
- b. Oversee the development, implementation, and maintenance of the bank's information security program, including assigning specific responsibility for its implementation and reviewing reports from management.

#### B. Assess Risk

- a. Each bank shall: Identify reasonably foreseeable internal and external threats that could result in unauthorized disclosure, misuse, alteration, or destruction of customer information or information systems
- b. Assess the likelihood and potential damage of these threats, taking into consideration the sensitivity of customer information
- c. Assess the sufficiency of policies, procedures, customer information systems, and other arrangements in place to control risks

#### C. Manage and Control Risk. Each bank shall:



- a. Design its information security program to control the identified risks, commensurate with the sensitivity of the information as well as the complexity and scope of the bank's activities. Each bank must consider whether the security measures are appropriate for the bank and, if so, adopt measures the bank concludes are appropriate.
  - b. Implement access controls on customer information systems, including controls to authenticate and permit access only to authorized individuals and controls to prevent employees from providing customer information to unauthorized individuals who may seek to obtain this information through fraudulent means.
  - c. Implement access restrictions at physical locations containing customer information, such as buildings, computer facilities, and records storage facilities to permit access only to authorized individuals.
  - d. Provide encryption of electronic customer information, including while in transit or in storage on networks or systems to which unauthorized individuals may have access.
  - e. Have procedures designed to ensure that customer information system modifications are consistent with the bank's information security program.
  - f. Have dual control procedures, segregation of duties, and employee background checks for employees with responsibilities for or access to customer information.
  - g. Develop monitoring systems and procedures to detect actual and attempted attacks on or intrusions into customer information systems.
  - h. Include response programs that specify actions to be taken when the bank suspects or detects that unauthorized individuals have gained access to customer information systems, including appropriate reports to regulatory and law enforcement agencies.
  - i. Implement measures to protect against destruction, loss, or damage of customer information due to potential environmental hazards, such as fire and water damage or technological failures.
  - j. Train staff to implement the bank's information security program.
  - k. Regularly test the key controls, systems and procedures of the information security program. The frequency and nature of such tests should be determined by the bank's risk assessment. Tests should be conducted or reviewed by independent third parties or staff independent of those that develop or maintain the security programs.
  - l. Develop, implement, and maintain, as part of its information security program, appropriate measures to properly dispose of customer information and consumer information as required.
- D. Oversee Service Provider Arrangements. Each bank shall:
- a. Exercise appropriate due diligence in selecting its service providers.
  - b. Require its service providers by contract to implement appropriate measures designed to meet the objectives of these guidelines.
  - c. Where indicated by the bank's risk assessment, monitor its service providers to confirm that they have satisfied their obligations as required. As part of this

monitoring, a bank should review audits, summaries of test results, or other equivalent evaluations of its service providers.

- E. Adjust the Program. Each bank shall monitor, evaluate, and adjust, as appropriate, the information security program in light of any relevant changes in technology, the sensitivity of its customer information, internal or external threats to information, and the bank's own changing business arrangements, such as mergers and acquisitions, alliances and joint ventures, outsourcing arrangements, and changes to customer information systems.
- F. Report to the Board. Each bank shall report to its board or an appropriate committee of the board at least annually. This report should describe the overall status of the information security program and the bank's compliance with these guidelines. The report, which will vary depending upon the complexity of each bank's program, should discuss material matters related to its program, addressing issues such as risk assessment, risk management and control decisions, service provider arrangements, results of testing, security breaches or violations and management's responses, and recommendations for changes in the information security program.

### **Management**

An IT manager provides a service to the bank and bank customers. The position requires technical expertise; however, even more important is the necessity to understand banking. Networking decisions that “make it work” in many industries are simply too risky to pursue in the world of banking. The Board must take an active interest in the bank’s IT presence and its management.

#### **All organizations should have:**

- 1. An effective planning process that aligns IT and business objectives
- 2. An ongoing risk assessment process that evaluates the environment and potential changes
- 3. Technology implementation procedures that include appropriate controls
- 4. Measurement and monitoring efforts that effectively identify ways to manage risk exposure.

### **Operations**

Generally, discussions of IT operations are very similar to any other business function: Basically, what was decided, who will do it, and who will confirm it got done. Basic topics include:

- a. Implementation
- b. Documentation
- c. Environmental controls
- d. Physical and logical security
- e. Operational continuity and resiliency
- f. Adequate staffing and training
- g. Access to expertise

For more FFIEC guidance on IT operations, please refer to these links:

Summary in presentation form:

[http://www.ffiec.gov/ffiecinfobase/presentations/operation\\_presentation.pdf](http://www.ffiec.gov/ffiecinfobase/presentations/operation_presentation.pdf)

Booklet:

<http://www.ffiec.gov/ffiecinfobase/booklets/operations/operation.pdf>

### **Outsourcing and Supervision of Technology Service Providers**

Monitoring the risks associated with outsourcing is essential to establishing the true cost of any service provider. Generally discussions surrounding outsourcing include:

- a. Risk assessment and requirements definitions
- b. Service provider selection
- c. Contract negotiation and implementation
- d. Ongoing monitoring (financial, as well as technical)

For more FFIEC guidance on outsourcing, please refer to these links:

Summary in presentation form:

[http://www.ffiec.gov/ffiecinfobase/presentations/out\\_presentation.pdf](http://www.ffiec.gov/ffiecinfobase/presentations/out_presentation.pdf)

Booklet:

[http://www.ffiec.gov/ffiecinfobase/booklets/outsourcing/Outsourcing\\_Booklet.pdf](http://www.ffiec.gov/ffiecinfobase/booklets/outsourcing/Outsourcing_Booklet.pdf)

### **Retail and Wholesale Payment Systems**

Money flows in and out of a bank using instruments and processes such as checks, cards, ACH, local switches and more. Electronic processing requires not only the commitment of cash, but also the exchange of information to accomplish ATM payout or point of sale when funds are sufficient. Analysis includes:

- a. Strategic risk
- b. Reputational risk
- c. Credit risk
- d. Liquidity risk
- e. Legal risk
- f. Transactional risk

For more FFIEC guidance on retail and wholesale payment system, please refer to these links:

<http://www.ffiec.gov/ffiecinfobase/booklets/Retail/retail.pdf>

<http://www.ffiec.gov/ffiecinfobase/booklets/Retail/retail.pdf>

## Chapter VIII – Developing an Investment Policy

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### **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. Nebraska statutes and the *NCUA Agreement for Share Insurance* requires a credit union to have a formal, written investment policy.<sup>33</sup>

### **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.

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**Referenced Nebraska Statutes**

<sup>33</sup> Neb. Rev. Stat. § 21-1768 (Reissue 2007)

## Chapter IX – Developing a Funds/Assets Liability Management Policy

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### **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 volatility in funding sources and market rates resulting from the movement of interest rates and the 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.

## Appendix A - Nebraska Statutes Cited

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The Department lists banking and finance statutes on its Web site at <http://www.ndbf.ne.gov>. Although the statutes are listed for reference and informational purposes, the Department attempts to keep the links and documents updated and accurate.

The official versions of Nebraska laws are online from the Unicameral Web site at <http://www.nebraskalegislature.gov/>. Click on the link “Bills and Laws” to search Nebraska statutes by a keyword or by the statute chapter and article number.

### **Directors’ Compensation**

- <sup>1</sup> Neb. Rev. Stat. § 21-2088 (Reissue 2007)
- <sup>2</sup> Neb. Rev. Stat. § 21-176 (Cum. Supp. 2007)

### **Directors’ Borrowings**

- <sup>3</sup> Neb. Rev. Stat. § 8-143.01 (Cum. Supp. 2008)
- <sup>4</sup> Neb. Rev. Stat. § 21-1796 (Reissue 2007)

### **Directors’ Qualifications**

- <sup>5</sup> Rev. Stat. § 8-126 (Cum. Supp. 2007)
- <sup>6</sup> Neb. Rev. Stat. § 8-204 (Reissue 2007)
- <sup>7</sup> Neb. Rev. Stat. §§ 8-126, 8-204 (Reissue 2007)

### **Vacancies on the Board**

- <sup>8</sup> Neb. Rev. Stat. § 8-124.01 (Reissue 2007)
- <sup>9</sup> Neb. Rev. Stat. § 8-204 (Reissue 2007).
- <sup>10</sup> Neb. Rev. Stat. § 21-2082 (Reissue 2007)
- <sup>11</sup> Neb. Rev. Stat. § 21-1760 (Reissue 2007)

### **Change of Control - Election of New Board of Directors**

- <sup>12</sup> Neb. Rev. Stat. §§ 8-1501 to 8-1502 (Reissue 2007)
- <sup>13</sup> Neb. Rev. Stat. § 8-124 (Reissue 2007)

### **Duration of Appointment**

- <sup>14</sup> Neb. Rev. Stat. § 21-2082 (Reissue 2007)
- <sup>15</sup> Neb. Rev. Stat. § 21-1758 (Reissue 2007)

### **Annual Meeting of the Board**

- <sup>16</sup> Neb. Rev. Stat. § 21-1759 (Reissue 2007)

### **Directors’ Quorum**

- <sup>17</sup> Neb. Rev. Stat. § 8-124 (Reissue 2007)
- <sup>18</sup> Neb. Rev. Stat. § 21-1758 (Reissue 2007)
- <sup>19</sup> Neb. Rev. Stat. § 21-2093 (Reissue 2007)

### **Majority Rule**

- <sup>20</sup> Neb. Rev. Stat. § 21-2093 (Reissue 2007),  
Neb. Rev. Stat. § 21-1768 (Reissue 2007)

### **Regular Meetings of the Board**

<sup>21</sup> Neb. Rev. Stat. §§ 8-124 (Reissue 2007); 8-204 (Reissue 2007); 21-1767 (Reissue 2004)

<sup>22</sup> Neb. Rev. Stat. § 21-2091 (Reissue 2007)

### **Appointment of Officers**

<sup>23</sup> Neb. Rev. Stat. § 8-124 (Reissue 2007)

<sup>24</sup> Neb. Rev. Stat. § 21-1764 (Reissue 2007)

<sup>25</sup> Neb. Rev. Stat. § 21-2097 (Reissue 2007)

<sup>26</sup> Neb. Rev. Stat. §§ 8-124 and 21-20,100 (Reissue 2007)

### **Establishing Committees**

<sup>27</sup> Neb. Rev. Stat. § 21-2094 (Reissue 2007)

### **Directors' Examination – Required Procedures**

<sup>28</sup> Neb. Rev. Stat. § 8-124 (Reissue 2007), Neb. Rev. Stat. § 8-204 (Reissue 2007) and

Department rules 45 NAC 24 and 45 NAC 25.

<sup>29</sup> Neb. Rev. Stat. § 8-125 (Reissue 2007)

<sup>30</sup> Neb. Rev. Stat. § 8-124 (Reissue 2007), Neb. Rev. Stat. § 8-204 (Reissue 2007); 45 NAC 24

<sup>31</sup> Neb. Rev. Stat. § 21-1771 (Reissue 2007) and 46 NAC 11

### **Directors' Examination by a Certified Public Accountant or Public Accountant**

<sup>32</sup> Neb. Rev. Stat. § 21-1771 (Reissue 2007), 46 NAC 11

### **Investment Policy - Purpose of a Written Policy**

<sup>33</sup> Neb. Rev. Stat. § 21-1768 (Reissue 2007)