

American Bankers Association

2008 Community Bank Directors

Telephone Briefing Series

Directors and the Bank's Portfolios:

Understanding Bank Investments & Asset/Liability Management

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Discussion Outline

1. Enterprise-Wide Risk Management Oversight

- a. Asset/Liability Management is not a stand alone process – it's a key part of your board's enterprise-wide risk management oversight responsibilities that includes both the bank and the holding company.**
- b. Your board and management need to have clear risk management policies in place before market forces impact your institution.**

2. Asset/Liability Risk Management

- a. Total balance sheet – not just your bank's investment portfolio.**

3. Liquidity Risk Oversight

- a. Most important issue – without liquidity your financial institution is out of business.**
- b. Holding Company liquidity is typically provided by dividends from the bank to service its obligations - if dividends are restricted by regulatory action then new capital may be required to service debt.**
- c. Confirm that management performs regular "stress tests" and has a contingency funding plan.**
- d. Board members need to understand relationships between your bank's liquid assets and liability dependent sources of liquidity.**

4. Interest Rate Risk & Margin

- a. Net interest income is typically the largest contributor and potentially the most volatile component of your bank's earnings.**
- b. Your institution must have a clear rate-mismatch policy; i.e., every action should help reduce enterprise-wide interest rate risk.**

5. Credit Risk: Policy & Oversight

- a. Credit decisions are a management function – don't delegate up.**
- b. All assets (not just loans) are subject to credit risk.**
- c. Your bank's borrowings are subject to your bank's credit rating.**
- d. Deposits are subject to your bank's reputational risk.**
- e. Your large depositors may experience credit problems.**

6. Capital: Policy & Management

- a. Your entire board must understand your institution's consolidated capital leverage position and any debt service requirements.**
- b. Your entire board must understand and monitor your bank's regulatory capital requirements.**

7. Accounting Risk (Frequent board/committee education required)

- a. The constant march of "Fair Value" accounting leads to estimates of "liquidation" value rather than "going concern" value.**
- b. Hedge accounting is increasingly complex.**

8. Reputational Risk

- a. Negative media coverage can create a self-feeding self-fulfilling liquidity crisis for your bank.**

9. Governance & Oversight

- a. Your board committee's charter is your job description – make certain it accurately describes board oversight (not management) responsibilities and document your compliance with your charter.**
- b. Make certain your management team holds regular ALCO meetings and makes regular reports of its activities to your board committee.**
- c. Hold regular committee meetings with key managers to review ALCO actions, policy compliance, periodic forecasts and the accuracy of your bank's actual results with management's prior forecasts.**
- d. ASK QUESTIONS! Make certain your management team really understands the asset/liability simulation model utilized by your bank.**
- e. ASK QUESTIONS! Make certain your management can explain and you understand what your institution owns and owes.**
- f. Listen to your regulators.**

10. Executive Sessions

- a. Policies are implemented by people – your management team.**
- b. Provide a regular opportunity for independent board members to talk privately with one another - hold an executive session at the conclusion of each committee meeting.**