

**Bank:**

**Date of Exam:**

**Charter #:**

**Prepared By:**

## **#16 – MANAGEMENT (Risk Focused)**

### **ASSIGNMENT OVERVIEW**

The viability of a bank is contingent upon the quality of its management team, and the effectiveness of its management systems. The Board of Directors is ultimately responsible for the conduct of a bank's affairs, and thus must be informed and vigilant in administering its duties. The selection of competent management, and determination that all practices are prudent and in compliance with applicable laws and regulations, are among the most crucial elements of this task. Planning, policymaking, personnel administration, and internal communications also are important to ensuring that the bank is effectively run. For more guidance, refer to the FDIC Examination Manual's section on "Management Supervision, Administration and Control." Refer to the DOB's Reference Material documents for a list of reference materials applicable to this procedure.

### **INSTRUCTIONS**

Examiners must follow the requirements in the Examiner Bulletin addressing Guidelines for Procedures and Work Paper Documentation for Commercial Examinations.

All examiners performing these procedures must be listed above in the "Prepared By" section. All of the CORE ANALYSIS PHASE should be completed. Comments and findings for each step should be made in the comment box below each question. Reference to work paper documentation should also be included here. Documentation is to be sufficient to allow an audit trail of the examiner's thought process and all significant findings.

Information on the Summary of Findings page must tie back to the findings noted within the procedure. The SEIC/EIC will determine which information in the Summary of Findings will be included in the Report of Examination.

The EIC/AEIC should review this procedure when complete. Acknowledgement that this procedure has been reviewed by the EIC/AEIC will be noted on the SCOPE FORM.

**EXAMINERS ARE RESPONSIBLE FOR EXERCISING SOUND JUDGMENT AND UTILIZING REASONABLE INVESTIGATIVE AND ANALYTICAL SKILLS TO ARRIVE AT AN ACCURATE ASSESSMENT OF THE RISK PROFILE OF THIS SEGMENT OF THE INSTITUTION'S OPERATIONS. PERFORMING ALTERNATE PROCEDURES NOT LISTED WITH THESE GUIDELINES MAY BE NECESSARY TO COMPLETE THIS RISK ANALYSIS.**

# CORE ANALYSIS PHASE

## #16 Management

### 1. Corporate Records and Applications

#### 1a. Review the Certificate of Formation and By-Laws.

Determine whether any amendments have been made in the Certificate of Formation (formerly referred to as Articles of Association) since the last examination? If yes, determine compliance with the following:

- Is there evidence that prior approval was acquired from the owners of two-thirds of the capital stock as required by Section 21.364 of the Texas Business Organizations Code; and
- Is there evidence that the original and one copy of the Certificate of Formation or re-created Certificate of Formation were filed with the Banking Commissioner for approval as required by Texas Finance Code 32.101?

Review the bank's by-laws and determine:

- Do the by-laws appear appropriate for the needs of the bank?
- Are the by-laws being adhered to the Board?
- Have there been any changes to the by-laws since the last examination? If yes, explain the changes.

**If amendments made, compliance with:**

**Business Organizations Code §21.364:** Choose an item.

**Finance Code §32.101:** Choose an item.

*A response of "No" requires a comment.*

**Comments:**

**1b. Determine if the Department approved any corporate applications (i.e. merger, branch, etc.) since the previous examination. If yes, investigate if the approval was contingent upon any subsequent action(s) and if the contingency has been met. Comment on any noncompliance.**

**Comments:**

### 2. Stockholders and Board of Directors

#### *Meetings and Minutes*

**2a. Read and brief the minutes of all stockholders' and Board of Directors' meetings since the previous examination. Determine compliance with the Texas Business Organizations Code (BOC). *Include***

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*summary of minutes in 16-A of the work papers.*

1. Determine if there has been at least one regular stockholder meeting within the last twelve months at which the owners of a majority of the capital stock were present, either in person or by proxy, as required by [Section 21.351](#) of the BOC.
2. Document major actions taken in board meetings held since the previous examination which is not part of a normal monthly meeting. *Include in work papers.*
3. Review bank committee structure and the compensation received from being a committee member. Determine if payment is automatic, or contingent upon attendance. Note any weaknesses. *Include list of committees in workpapers 16-J.*

### Compliance with:

**Business Organizations Code §21.351:** Choose an item.

*A response of "No" requires a comment.*

### Comments:

**2b.** Determine compliance with the Texas Finance Code and Business Organizations Code relating to board of directors' meetings. Address the following:

- Has the bank had board meetings on at least a monthly basis, as required by Section 33.105(a) of the Texas Finance Code (TFC)? If board meetings are less frequent, has this been approved by the Commissioner?
- Determine if the board approves the minutes and sufficiently reviews the operations, activities, and financial condition of the bank, as required by § 33.105(a) of the TFC?
- Determine if any meetings lacked a majority of board members, in which case there was no quorum as per [Section 21.413](#) of the BOC.
- Determine if the board elected a principal executive officer and an officer responsible for corporate books and records as required by TFC §33.106. Indicate who performs these duties in the comment section.

### Compliance with:

**Finance Code §33.105(a):** Choose an item.

**Finance Code §33.106:** Choose an item.

**Business Organizations Code §21.413:** Choose an item.

*A response other than "YES" requires a comment.*

### Comments:

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**2c.** Determine if there were any transactions between the bank and directors or their interests. If yes, then address the following:

- Determine if the board approved any and all transactions between the bank and directors or their interests. Did the interested director(s) abstain from voting on the matter?
- As per TFC §33.109(a)(1), did the bank obtain prior approval of a disinterested majority of the board before selling, leasing, or purchasing any assets to (or from) an officer, director, or principal shareholder of the bank **OR** officer, director, or principal shareholder **OF** an affiliate of the bank? If not, did the bank obtain written approval of the Banking Commissioner? Refer to 7 TAC §3.22, relating to sale or lease agreements with officer, director, principal shareholder, or affiliate.

Note: If the transaction is covered by 23A or 23B of the Federal Reserve Act, then TFC Section 33.109 does not apply per 7 TAC §3.22(f). Federal Reserve Act §23A & 23B relates to transactions with affiliates, which are defined as entities, whereas Texas Finance Code §33.109 applies to individuals (or natural persons). Refer to Appendix IV for additional guidance.

- As per TFC §33.109(a)(2), did the bank obtain the prior approval of a disinterested majority of the board before consummating, renewing, or extending a real property lease in which an officer, director, manager, managing participant, or principal shareholder of the bank, or of an affiliate of the bank, has an interest? If not, did the bank obtain written approval of the Banking Commissioner?

### Compliance with:

**Finance Code §33.109(a)(1):** Choose an item.

**Finance Code §33.109(a)(2):** Choose an item.

**Federal Reserve Act Section 23A Relations with Affiliates:** Choose an item.

**Federal Reserve Act Section 23B Restrictions on Transactions with Affiliates:** Choose an item.

*A response other than "YES" requires a comment.*

### Comments:

**2d.** Determine if there are advisory directors attending the board meetings that need to sign a confidentiality agreement. Is confidential information related to the bank or bank's customers disclosed? Per TFC §33.104, did the board adopt a resolution that identifies the advisory director and describes the purpose for disclosure of the information? Has the advisory director signed a confidentiality agreement? To clarify, a confidentiality agreement would need to be signed by an outside advisory director, that is, a person who is not employed by the bank or holding company. An officer or employee of the bank or holding company is already subject to confidentiality obligations and the threat of enforcement.

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### Compliance with:

**Finance Code §33.104:** Choose an item.

*A response other than "YES" requires a comment.*

### Comments:

#### *Compliance with Applicable Texas Finance Code and Regulation O Requirements*

**2e.** Verify compliance with applicable Texas Finance Code articles and Regulation O requirements relating to the board of directors. Address the following:

1. Does the bank have between five and twenty-five directors, the majority of whom are Texas residents, as required by TFC §33.103(a)?
2. Is the principal executive officer a qualified member of the board as required by TFC §33.103(a)?
3. Is there is evidence that any director may be prohibited from serving due to exclusionary factors listed in TFC §33.103(b):
  - A judgment against him/her in favor of the bank?
  - A charged off obligation at this bank?
  - A felony conviction?
4. Have all directors been elected within the last twelve months, and any interim vacancies been properly filled, as required by TFC §33.103(d)?
5. Has each director taken an oath of acceptance as required by TFC §33.103(e) prior to taking office?
6. Confer with examiner performing the Loans and Leases procedure regarding EIC review of records maintained on insiders to comply with the Regulation O requirements. Record keeping and disclosure requirements are in 12 CFR 215.8 (Regulation O) made applicable to state nonmember banks by 12 CFR 337.3

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### Compliance with:

Finance Code §33.103(a): Choose an item.

Finance Code §33.103(b): Choose an item.

Finance Code §33.103(d): Choose an item.

Finance Code §33.103(e): Choose an item.

### Regulation O (answer one):

Non-FRB Member 12 CFR 337.3: Choose an item.

OR

FRB Member 12 CFR 215.8: Choose an item.

*A response other than "YES" requires a comment.*

### Comments:

### *Board Composition and Interaction*

**2f.** Review the information on the directors to determine the quality of board composition and interaction. Address the following:

- Does there appear to be a reasonable range of knowledge/expertise among board members to meet the needs of the bank as well as those of the local economy?
- Are there sufficient outside directors to provide alternative perspectives and objectivity?
- Have all directors demonstrated active participation in the board through attendance of regularly scheduled meetings?
  - Is there any member who has attended less than 50% of the meetings?
- Does the bank have any advisory directors, and if yes, what is their role?
- Do directors' fees appear reasonable for the size and condition of the institution, and for the contribution of individual directors?
- Is there any evidence of prohibited Management Official Interlocks under [12 CFR 348](#) for state nonmember banks (or [12 CFR 212](#) (Regulation L) for state member banks)?

In general, these regulations prohibit bank managers and directors from serving at the same time as a management official of an unaffiliated depository organization, if the institutions are located or have offices in the same community.

### Compliance with (answer one):

Non-FRB Member 12 CFR 348: Choose an item.

OR

FRB Member 12 CFR 212: Choose an item.

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*A response other than "YES" requires a comment.*

**Comments:**

### *Meeting Materials*

**2g.** Review the information provided in the board packets for the directors to determine if the board receives accurate information on a regular basis to supervise the activities of the bank. The review of information going to the board also occurs within the examination of the separate functional areas. Consult with examiners performing reviews of same or similar materials.

Review a board packet from the most recent board meeting and a sample from a previous quarter not currently part of the scope.

- Determine if (a) the board receives sufficient information on a regular basis to supervise the activities of the bank; (b) the reports are accurate. Assess the quality of the board packet and indicate what was reviewed in the comment section.
- Determine if the board package contain at a minimum, the following information. Test the quality of those reports by reviewing a sample from a non-financial date.
  1. A monthly statement of condition and income used for comparative analysis between projections and performance, with notes explaining any significant deviations?
  2. Detailed investment reports which delineate any fluctuations in book/market values as well as any transactions which have occurred?
  3. Detailed reports which indicate any significant transactions, trends and/or changes noted within the loan portfolio, including delinquency activity?
  4. A copy of the watch list?
  5. A review of the adequacy of the allowance for loan and lease losses?
  6. An analysis of the bank's capital position?
  7. A listing by type and amount of borrowings by the bank?
  8. An analysis of the bank's liquidity position?
  9. An analysis of the bank's interest rate sensitivity position?
  10. A list of any new litigation and a status report on existing litigation?
  11. A report on any major endeavors, such as mergers, acquisitions, branch applications, and/or material building plans?

**Comments:**

### **3. Management Actions**

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**3a.** If the bank is under any form of administrative action, evaluate the steps taken by the Board since the previous examination to reach compliance with the administrative action.

**Comments:**

**3b.** Comment on the nature and level of current/previous violations of law and management's ability/actions to make corrections.

**Comments:**

### 4. Management's Ability

**4a.** If any specialty examinations (Trust, IT, or Compliance) received a less than satisfactory composite rating, consider the impact to the overall management rating at this examination.

If Compliance/CRA ratings were less than satisfactory, include a brief narrative for the confidential section of report summarizing the Compliance/CRA examination findings and status of the bank's corrective actions. If deficiencies were not corrected, or if questions arise as to whether the bank's actions have been adequate, the EIC will contact the RD or RRE to discuss further actions needed.

**Comments:**

**4b.** Determine if management plans effectively. Consider the Strategic Plan, budget process, profit plan, and growth projections. If deficiencies are noted with management's ability to plan or with the bank's Strategic Plan, comment on the weaknesses. Refer to the [Appendix I](#) for guidance. *Include copy of strategic plan in 16-E of the work papers.*

**Comments:**

**4c.** Assess management's ability to recruit and maintain adequate and capable personnel and comment on deficiencies, addressing weaknesses regarding the bank's hiring program, training, excessive turnover, and management succession. Refer to the [Appendix II](#) for guidance.

**Comments:**

**4d.** Discuss the LIBOR Transition with management to understand their awareness of and readiness for a transition away from LIBOR to alternative reference rates. For nonmember banks, complete the FDIC LIBOR Work Program for institutions with Total Assets Less than \$10 Billion.

**Comments:**

### 5. Organizational Chart



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**5a.** Review the organizational chart to determine if it accurately portrays the structure of the bank and if it provides a well-organized division of duties. Comment on any deficiencies considering the size and complexity of the bank. *Include copy of the organizational chart in 16-H of the work papers.*

**Comments:**

**5b.** Determine if any concentrations of authority exist. Consider if any individual controls or dominates the board; controls the board reporting; or all areas of policies and operations. Refer to [Appendix III](#) for potential controls to reduce the risks of having one dominant official in the organization. *Comment on any deficiencies in segregation of duties, director independence and involvement, audit functions, code of conduct/ethics/conflict of interest policies and practices, and internal loan review.*

**Comments:**

### 6. Personnel Issues

**6a.** If the bank has an employment contract with any employee, which limits the bank's ability to immediately terminate the employee for ineffective, inefficient, or dishonest behavior, determine compliance with Section 33.106 of the TFC and [12 CFR 359](#).

**Compliance with:**

**Finance Code §33.106:** Choose an item.

**12 CFR 359:** Choose an item.

*A response other than "YES" requires a comment.*

**Comments:**

**6b.** Determine if executive officers' salaries and other forms of compensation appear inappropriate in relation to duties, performance, and peer group average. Determine if compensation appears to be too low or excessive for executives or staff whose activities could pose material risk to the organization.

Consider the following:

- Are executive officer salaries and other forms of compensation reviewed by the board for appropriateness in relation to duties, performance, peer, etc.? How is compensation determined? Does the board review and approve compensation packages for executive management?
- Does the board or a committee thereof, at least annually evaluate the chief executive officer's performance as it relates to the overall safety and soundness of the institution, compliance with regulatory laws and policy statements, and compliance with internal policy and board directives?

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- How does the CEO's compensation compare with the Federal Reserve Board Salary Survey for average salaries?
- Do the type and amount of expenses appear reasonable for benefits derived?
- In select circumstances, examiners may want to review a sample of credit card or other personal-type expenses paid by the bank to ensure that expenses appear appropriate.
- Review fringe benefits (country club memberships, automobile, etc.) paid on behalf of executive officers.
- Is the compensation amount unreasonable or disproportionate to the services provided as per the Interagency Guidelines Establishing Standards for Safety and Soundness (12 CFR 364 for nonmembers, and 12 CFR 208 (Regulation H) Subpart D for member banks)?

**Compliance with (answer one):**

**Non-FRB Member 12 CFR 364:** Choose an item.

**OR**

**FRB Member 12 CFR 208:** Choose an item.

*A response other than "YES" requires a comment.*

**Comments:**

### 7. Final Analysis

7. Assess the overall capability and performance of management and the board of directors. Prepare a Management comment and assign a rating for the bank. Refer to Supervisory Memorandum 1001. Complete the Summary of Findings.

## SUMMARY OF FINDINGS

### #16 - MANAGEMENT

Describe all strengths evident from the evaluation.

Describe all weaknesses evident from evaluation, including violations of law/regulation/rules; noncompliance with Departmental policies/guidelines; internal policy deficiencies/noncompliance; internal control weaknesses; MIS problems; and deficiencies in management supervision.

Determine why weaknesses exist and comment on management's response and plan of action. Identify bank personnel making the response.

**SUMMARY RISK RATING ASSIGNED:** Choose a Rating

**Ratings: 1-Strong; 2-Satisfactory; 3-Less than satisfactory; 4-Deficient; 5-Critically deficient; NR-Not Rated**

*Provide copy of this page to EIC/AEIC. Receipt and review of this form by the EIC/AEIC will be evidenced by his/her initials in the appropriate column for this procedure on the SCOPE FORM*

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# APPENDIX I

## Management's Ability to Plan / Evaluating Strategic Planning

### Consider how major decisions are made:

- Is the bank independent or part of a holding company?
- Who makes decisions related to acquisitions, divestitures, and branching?
- How involved are the directors?
- For holding company banks, is there a degree of autonomy in product development, advertising, market research, etc.?

### Consider the techniques used by management in planning:

- What is the role of the CEO?
- What is the level of involvement of Directors, senior managers, and middle managers in the planning process?
- How are goals and objectives communicated to all employees?

### Consider the following when evaluating strategic and capital planning:

Refer to Supervisory Memorandum 1009 "Business Plans and Strategic Planning" for guidance.  
Also consider:

- Does the bank have any formal plans outlining short- and long-term goals, and strategies for meeting such?
- Are plans based upon reasonable assumptions?
- If expansion/growth is envisioned, do plans indicate a realistic means of maintaining capital adequacy?
- Do the plans address:
  - a. Competition
  - b. Technology
  - c. Customer wants and needs
  - d. New products
- Are the plans consistent with the bank's:
  - a. Financial condition
  - b. Facility
  - c. Location
  - d. Customer base
  - e. Management ability
- Is the bank operating within the framework of the plan, or has significant deviation occurred?

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## APPENDIX II

### Recruiting and Maintaining Adequate and Capable Personnel

Recruiting, training, and personnel activities are vital to the development and continuity of a quality staff. Some features of good personnel administration are a designated organization structure, detailed position descriptions, carefully planned recruiting, appropriate training and developmental activities, a performance appraisal system, quality salary administration, and an effective communications network.

Consider the following:

1. Does the bank have an ongoing hiring program to ensure consistency in qualified hires?
2. Do performance standards exist to assist in fair and consistent evaluations?
3. Are training programs employed?
4. Is there sufficient staffing to provide for management succession in all important functions?
5. Does there appear to be excessive turnover, which may indicate other management problems?
6. Are salaries consistent with the local economy and competition?
7. Does the bank have a vacation policy?

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## APPENDIX III

### Concentrations of Authority & Potential Controls

If the bank or the board is dominated by one official, it is important to assess the bank's control environment. The following serve as potential controls to mitigate the risk posed by a dominant individual of authority.

Consider and assess whether:

1. An appropriate segregation of duties and responsibilities is achieved, or alternative actions are taken to mitigate the level of control exercised by the one individual.
2. Director involvement in the oversight of policies and objectives of the bank is at an appropriate level.
3. The diversity of the board membership provides the bank with an assortment of knowledge and expertise, including, but not limited to, banking, accounting, and the major lending areas of the bank's target markets.

4. There are a sufficient number of outside and independent directors.
5. Committees of major risk areas exert a proper level of function, responsibility, and influence, and the value of the committees is exhibited in the decision-making process. If a committee is chaired by a member of executive management, consider the impact on the committee and the decisions of the committee. Consider the dollar threshold for committees (such as loan committees) and whether it is appropriate.
6. A proper level of independence has been achieved for board committees of major risk areas, including, but not limited to, audit committees.
7. An adequate audit committee has been established with only, or at least a majority of, outside directors.
8. A need exists for the performance of annual financial audits by an independent certified public accounting firm.
9. A qualified, experienced, and independent internal auditor is in place at the bank.
10. A proper segregation of the internal audit function is achieved from operational activities.
11. An appropriate rationale was established regarding changing a bank's external auditors, independent of oral discussions with bank management, including, but not limited to, a review of the audit committee minutes or a review of auditor notifications.
12. Adequate written code of conduct and ethics and conflicts of interest policies has been established.
13. A need exists for the bank's board to perform and report on an annual conflict of interest and ethics review.
14. A need exists for a bank to engage outside consultants to conduct an external loan review.
15. A proper segregation of the internal loan review process is established.

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## APPENDIX IV

### Transactions with Management and Affiliates

When an insider transaction has occurred, examiners should initially review compliance with Federal Reserve Act [23A Relations with Affiliates](#) & [23B Restrictions on Transactions with Affiliates](#).

TFC 33.109 *Transactions with Management and Affiliates* and the applicable rules under TAC 3.22 *Sale or Lease Agreements with an Officer, Director, Principal Shareholder, or Affiliate* should be applied in situations where the transaction is not subject to and not in compliance with Federal Reserve Act 23A & 23B.

- If the transaction is subject to and in compliance with sections 23A & 23B, and documentation efforts are adequate, no further compliance review is needed.
- If the transaction is with individuals / natural persons, i.e. officers, directors, or principal shareholders of the bank, or officers, directors, or principal shareholders of the affiliate, it is subject to TFC §33.109 and TAC §3.22.
- If there is an apparent violation of TFC 33.109 cited in the report of examination, then TAC 3.22 should also be referenced.

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# Management Worksheet I

## ANNUAL SHAREHOLDER COMPOSITION AND MEETING INFORMATION

**Date of Last Shareholder’s Meeting:**

**Number of Shares Voted (as Amended or by Board Resolution):**

**Directors Elected (listed below)**


**Dividends Declared**

Date	Amount	Date Payable

**Recent Public Bank Stock Trades (Sales)**

Date	Price	#of Shares

**New Capital Issued**

Date	Par Value	Selling Price

**Surplus Adjustments**

Date	Amount	Date Certified

**Reason:**

**Amendments to By-Laws**

Date	Amendment





