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Maintaining a Healthy Relationship with Your Regulators

WHITE PAPER

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Executive Summary

Banking has often been described as a relationship business, where the nature and quality of your relationships with those who keep your bank in business—your customers—routinely makes the difference between success and failure. Therefore, well-run banks, and smart bankers, devote a great deal of time and energy to developing and maintaining their customer relationships.

Like it or not, however, a bank's relationships with its financial regulatory agencies are now almost as important as its customer relationships. Why is that? As the lawyers and examiners alike will tell you, a bank is subject "to comprehensive regulation and supervision" by one or more primary financial regulatory agencies. Put in plain English terms, a bank's primary regulator is with the bank from cradle to grave; it can regulate the bank pretty much on its own terms within the bounds of the law, and it has the power to clamp down on a bank's activities or even put it out of business.

So, getting along with your regulators really does matter, and bankers nowadays generally understand the importance of sound regulatory relationships. There are ten basic guidelines that can help a board develop and maintain sound relationships with their financial regulators.

Getting Prepared

Good regulatory relationships flow without exception from proper preparation. Put another way, don't even think about talking to your regulators before you do your homework. In turn, there are three basic steps in the homework process.

1. Understand the regulators' mission, perspective and processes. The bank regulators are charged with administering an ever-growing amount of laws, regulations and other requirements. At the same time, the essential mission of the bank examination process has not changed: to ensure the safe and sound operation of the bank. In addition, bank examination and supervision fundamentally is risk-based, and the identification, assessment and management of risk are at the core of what every bank examiner does. Bank supervision and examination also is process-based: banking agency supervisors conduct their activities in accordance with a wide array of bulletins, circulars, advisories, manuals, checklists, and other guidance. Do you have a general familiarity with the laws, regulations and supervisory requirements that apply to your bank? Have you spent time trying to understand how the examination process works? Even spending a few hours going through your primary agency's examination or inspection manual can help develop a sense of how examination activities are organized and how your regulators think.

2. Understand what the regulators expect of bank directors. As every bank director knows, the duties of a director have become increasingly substantial and higher-risk. Much of this increased responsibility flows directly from the well-articulated regulatory view that bank directors have ultimate legal and fiduciary responsibility for assuring the safe and sound operation of their bank. The regulatory agencies, however, believe that a bank director owes a duty not only to the bank's shareholders but also to the bank's depositors, employees, the communities in which the bank does business, the federal Deposit Insurance Fund and even its regulators. Regulators also believe that a bank's risk and compliance profile are the direct responsibility of the bank's

directors, who are expected to set and enforce the "tone at the top," and ensure the retention of appropriate management resources, the creation of a strong corporate governance and accountability infrastructure documented by written policies and procedures, appropriate supervision of management, and proper attention to problems and their correction. Understanding these regulatory expectations is an essential prerequisite for establishing a positive regulatory relationship.

One very good summary of bank director duties and responsibilities can be found in the Office of the Comptroller of the Currency's *The Director's Book: The Role of a National Bank Director* (October 2010) (<http://www.occ.gov/publications/publications-by-type/other-publications-reports/director.pdf>), which has been in print for more than 20 years but still summarizes concisely one principal agency's views of a bank director's duties. In addition, the Federal Deposit Insurance Corporation's *Pocket Guide for Directors* (December 2007) (<http://www.fdic.gov/regulations/resources/directors>) is another useful source of relevant information on the issue of director duties and responsibilities.

3. Know your bank. As painfully self-evident as this guideline may appear at first gloss, there is more in it than meets the eye. Knowing the bank doesn't just mean understanding its financial statements, business lines and markets—it also means understanding and being able to articulate the bank's overall mission and strategic plan, its overall risk tolerance, its governance and risk management infrastructure, and an understanding of the economic and regulatory environment in which the bank operates. It further means being involved in the bank's activities and operating environment by staying abreast of market and regulatory developments, regularly attending board and committee meetings, and staying current on regulatory examinations and their results.

Being Involved

Once prepared, a bank director has the advantage of being informed and more confident in developing good regulatory relationships. The relationship-

development process is dynamic, and it pays to be flexible and adaptive as changes in circumstances warrant. But in the final analysis, good regulatory relationships invariably involve variations on the seven principles summarized below.

1. *Personal relationships matter.* Bank directors, in particular outside directors, may not have the same level of day-to-day contact with field, regional and Washington (or state) supervisory officials as line executives, and therefore may not have as many opportunities to develop those all-important personal relationships. In addition, examiners get reassigned and supervisors get promoted, so a bank's supervisory contacts will change over time. But making a proactive effort to get to know one's principal regulatory supervisors is always a good idea, and that can be done through a variety of planned outreach efforts.

2. *Listen, listen, listen.* A key rule in talking to regulators is to listen to them. Bank supervisors have an array of formal and informal mechanisms for communicating with their constituents, with reports of examination, director letters and exit meetings falling into the former category, and informal conferences and even hallway encounters falling into the later category. "Listening" to formal communications is as easy—or difficult—as reading examination reports and major supervisory correspondence, and paying close attention at exit meetings. Bank directors may be less likely to have informal sandwich sessions with their examiners than may be the case with bank executives and other line officials, but any interaction with an examiner or supervisor is an opportunity not only to find out what the regulators think of your institution and what they would like you to do, but also to show your regulators that you are open and receptive to their communications.

3. *Be organized, open, thoughtful and forthright in regulatory communications.* Director communications with regulators need to be organized, for the simple reason that regulators will assume—unless you tell them otherwise—that you are speaking on behalf of the bank. In general, scattershot, off-

the-cuff communications between multiple directors and its regulator at best may give the regulator the impression of board disorganization and lack of discipline. In addition, communications—whether oral or written—should be plain and unambiguous and, of course, complete, accurate and not misleading.

An issue that I have frequently encountered during the course of my work with depository institutions is whether a bank "should be telling its regulator about XYZ subject matter" or activity, especially a piece of negative news or information. While there is no hard-and-fast rule here, the better course of action in most cases is to assume that anything affecting the bank is something that its primary regulator will find out about at some point. If so, better that the examiners find out from the bank rather than finding out on their own. You—and the bank—will receive credit for forthrightness, even if the news is bad.

4. *Show the regulators that you want to cooperate—and mean it.* The difference between positive and negative regulatory relations often comes down to whether a regulator believes that a bank and its board of directors are genuinely open to regulatory input—including criticisms—and to working cooperatively with the regulator to address outstanding issues or concerns. That not only means telling the bank's regulator that the board wants to cooperate, but backing those assurances up with meaningful action. And, from the director's standpoint, it also means ensuring that bank management is similarly committed to cooperation.

5. *Know the right way to disagree.* Contrary to the belief of many bank directors, a bank and its directors can disagree with regulatory findings, conclusions and actions, so long as disagreements are handled correctly. In all cases, disagreements should be based on facts and supporting regulatory requirements and principles, and communicated in an even-handed manner. The more difficult issue for many bank directors is taking regulatory disagreements to higher levels within the regulatory agency if the bank does not receive satisfaction at the on-site or field levels. The best method of taking disagreements up

the chain of command will be based on the specific facts and circumstances, but approaching the escalation process in a direct and forthright manner, and keeping regulatory examiners and other staff in the chain of command informed of bank communications, generally is the better way to proceed. And, in almost all cases the urge to enlist outside support—such as from the bank’s U.S. senator or representative—to resolve disagreements should be thoroughly suppressed; more likely than not, this approach will backfire outright.

6. *Keep your promises.* This point needs no explanation, other than to remind directors that it is their responsibility to oversee the bank’s commitments to corrective or remedial measures.

7. *Treat your regulators as you treat your customers.* Well-managed banks know how to communicate with their customers, and understand that positive customer relationships will take time and work to develop, whereas it may take only one misstep to ruin a previously good relationship. Why not use the same approach with regulators?

In the final analysis, building positive regulatory relationships is a process that is designed to earn the bank, and its directors, the trust and confidence of its primary regulator. That trust and confidence is regulatory “money in the bank” which can stand in good times and bad, and is well worth the effort to develop and maintain.